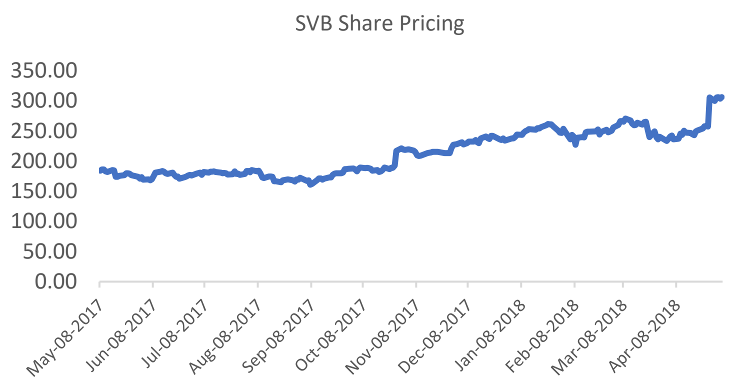


Recommendation: SELL

Please see the disclaimer at the back of this report for important information

Current Price: $305.82 Fair Value Estimate: $162.39 12-Month Target: $178.55



Valuation Multiples based on Current Capitalization

Multiple	SIVB	Industry
P/E (LTM)	27.99x	19.3x
P/BV	3.67x	1.4
Price/Tang BV	3.67x	1.8x

Market Data as of 5/4/2018, S&P Capital IQ

Investment Highlights

- Growth has been strong over the last few years. Between 2012 and 2017 Revenues doubled to $1.98 billion while EPS grew 135% to $11.08. However, we think some of these tailwinds are secular trends that may soon dissipate. Tighter liquidity may adversely affect cheap funding which has been critical to positive performance. Currently, only 22% of deposits are interest bearing.

- While international expansion could mitigate some of the slowdown, we think it may be too small to offset expected weakness in US business. Europe recently reached $2bn in loans while SVB just received approval to open a leading branch in Canada.

- Despite somewhat aggressive projections (Management guidance of 30% growth in interest income in 2018), we are unable to justify current premium from industry average valuation.

Overview of Historical Financial Performance

SVB is a diversified financial services company that generates revenues from both traditional and investment banking. While transaction fees have grown recently as the company invested in its treasury and asset management platform, the bulk of the revenues comes from interest income. Both segments have been positively boosted by developments in capital markets over the last few years. In the Q1 18 earnings call, management acknowledges the boost from these tailwinds, specifically citing “strong client liquidity, healthy balance sheet growth, higher rates, strong core fee income and stable credit quality” and more recently lower tax rates.

There has also been positive news on the international front with Europe recently “crossing the $2 billion threshold in loan balances in the first quarter” as momentum builds across Europe. SVB expects imminent approval for its first branch in Germany and has just received “formal authorization from Canada's Minister of Finance to establish a lending branch in Canada and are now awaiting final approval from the Superintendent of Financial Institutions”

Based on these factors, management expects FY 18 performance to be strong and has made significant upward revisions to its expected outcomes for the year.

Q1 Performance Summary

On a quarter-on-quarter basis, management reports “Net interest income increased by 6.5% to $421 million, average loans grew 6.1% to $23.8 billion. Average total client funds grew by 7.9% to $110.5 billion. Core fee income increased by 8.1% to $115 million and delivered a return on equity of 18.1%.” These results embody better than expected performance on many fronts and “healthy activity among our clients, particularly private equity, life sciences and international” even as the overall pipeline remains strong.

Business outlook and Value Drivers

Despite this positive overall trend, we are not as bullish in terms of forward looking expectations as management especially longer-term post 2018. A key element of this cautiousness is that, by our assessment, the strong performance has largely ridden the secular wave of cheap liquidity (which management clearly acknowledges) and ‘de-risked’ capital markets and based on recent events we expect these secular drivers to fade or slow significantly. Already, rising rates imply the liquidity deluge is at an end and while tax rates will continue to boost performance near-term (management reports a $0.56/share benefit, from December’s tax cuts, in Q1 18 alone) we expect competition to intensify within the next couple of years. As bigger banks start to seek out alternative growth opportunities in markets previously ignored, we expect smaller banks like SVB to feel the pinch. For instance, while SVB acquired 1,300 new commercial clients in Q1 18, its highest rate of client acquisition ever, we envisage it will be difficult to sustain that momentum as competition tightens. Furthermore, we consider the international expansion at its current size to be of limited benefit in mitigating domestic competitive pressures even as we do not consider either the European or Canadian market to be of significantly higher return potential than the US market. Overall, we estimate a 17% y-o-y growth in gross loans.

Composition of Loans	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Commercial Loans	14,316	17,070	19,846	23,220	27,168	31,786	37,190	43,512	50,909
% Growth	*15%*	*19%*	*16%*	*17%*	*17%*	*17%*	*17%*	*17%*	*17%*
Commercial Mortgage Loans	692	723	712	741	770	801	833	867	901
% Growth	*7%*	*4%*	*-1%*	*4%*	*4%*	*4%*	*4%*	*4%*	*4%*
Residential Mortgage Loans	1,543	1,926	2,298	2,643	3,039	3,495	4,019	4,622	5,315
% Growth	*38%*	*25%*	*19%*	*15%*	*15%*	*15%*	*15%*	*15%*	*15%*
Consumer Loans	227	241	328	427	555	722	938	1,220	1,585
% Growth	*41%*	*6%*	*36%*	*30%*	*30%*	*30%*	*30%*	*30%*	*30%*
Other Loans	79	65	69	73	78	83	87	93	98
% Growth	*1%*	*-17%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*	*6%*
Total Gross Loans	16,857	20,025	23,254	27,104	31,610	36,886	43,068	50,313	58,809
% Growth	16%	19%	16%	17%	17%	17%	17%	17%	17%

Yields on loans have average about 4.7% over the last three years. For the rest of 2018, we forecast a 50-basis points improvement from two rate hikes and a further 50 basis points improvement in 2019, stabilizing thereafter since we have no visibility on Fed decisions post 2019.

Interest Income on Loans	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Average Loans	*15,372*	*18,100*	*21,263*	*24,718*	*28,798*	*33,608*	*39,236*	*45,830*	*53,557*
Yield on Loans	*4.51%*	*4.61%*	*4.82%*	*5.32%*	*5.82%*	*5.82%*	*5.82%*	*5.82%*	*5.82%*
Interest Income on Loans	**693**	**834**	**1,026**	**1,316**	**1,677**	**1,957**	**2,285**	**2,669**	**3,119**

The growth in loans would have to be supported by increased borrowing in the fed funds market as well as increased deposit mobilization. Our deposit growth is implied by increasing loan to deposit ratios from the current 52% level to about 60% in 2023.

Deposits									
	2015	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Loan to Deposit Ratio	42%	50%	52%	56%	57%	58%	58%	59%	60%
Net Loans	16,524	19,675	22,851	26,584	31,013	36,203	42,270	49,391	57,723
Total Deposits	39,143	38,980	44,254	47,573	54,709	62,915	72,353	83,206	95,687
% Interest Bearing	*21%*	*18%*	*17%*	*24%*	*26%*	*28%*	*30%*	*32%*	*34%*
Interest Bearing Deposits	*8,275*	*7,004*	*7,599*	*11,229*	*14,007*	*17,366*	*21,418*	*26,295*	*32,153*
Average Interest Bearing Deposits	*8,275*	*7,004*	*7,599*	*11,229*	*14,007*	*17,366*	*21,418*	*26,295*	*32,153*
Cost of Funds	*0.11%*	*0.11%*	*0.10%*	*0.35%*	*0.60%*	*0.60%*	*0.60%*	*0.60%*	*0.60%*
Interest Expense on Deposits	**5.4**	**5.6**	**8.7**	**33.2**	**76.0**	**94.5**	**116.9**	**143.8**	**176.1**

Total Borrowing									
	2015	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Borrowings	1,602	1,373	1,838	5,513	6,616	7,939	9,527	11,433	13,719
% Growth	*226.8%*	*-14.3%*	*33.9%*	*200.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
Average Borrowings	*1,046*	*1,488*	*1,605*	*3,676*	*6,065*	*7,278*	*8,733*	*10,480*	*12,576*
Cost Of Borrowings	*0.44%*	*0.50%*	*0.54%*	*0.79%*	*1.04%*	*1.04%*	*1.04%*	*1.04%*	*1.04%*
Interest Expense on Borrowings	**35**	**37**	**36**	**29**	**63**	**76**	**91**	**109**	**131**
Total Interest Expense	**40**	**43**	**45**	**62**	**139**	**170**	**208**	**253**	**307**

- **Revenue growth should persist, but we are not as bullish as management**

We also expect fee income to stay strong, especially in light of management's reports of stronger PE and Venture capital funding than ever and its expectation of increased IPOs in 2018. Considering limited guidance further out, we factored expectation for slower client growth and increased encroachment by bigger banks in more modest projections for fee income growth over the rest of our forecast horizon, averaging at about 15% down, from 22% in the past year.

Total Investment Securities									
	2015	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Total Investments	26,290	21,997	25,124	28,893	33,226	38,210	43,942	50,533	58,113
% Growth	*14.3%*	*-16.3%*	*14.2%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*

Interest Income on Investments									
	2015	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Average Investments	*24,643*	*24,144*	*23,561*	*27,008*	*31,059*	*35,718*	*41,076*	*47,238*	*54,323*
Yield on Investments	*1.43%*	*1.49%*	*1.86%*	*2.36%*	*2.86%*	*2.86%*	*2.86%*	*2.86%*	*2.86%*
Interest Income on Investments	**354**	**359**	**439**	**639**	**890**	**1,023**	**1,177**	**1,353**	**1,556**

Non Interest Income									
	2015	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Trust Income	47	53	59	68	76	87	98	112	127
% Growth	*16.9%*	*12.5%*	*11.8%*	*15.0%*	*13.1%*	*13.3%*	*13.8%*	*13.4%*	*13.5%*
Mortgage Banking Activities	57	68	77	94	111	131	157	186	221
% Growth	*35.6%*	*20.4%*	*12.2%*	*22.7%*	*18.4%*	*17.8%*	*19.7%*	*18.6%*	*18.7%*
Gain on Sale of Invest. & Securities	160	90	119	94	84	84	75	70	66
% Growth	*-52.5%*	*-44.1%*	*32.9%*	*-21.2%*	*-10.8%*	*0.3%*	*-10.6%*	*-7.0%*	*-5.8%*
Other Non-Interest Income	209	246	303	370	447	546	664	808	984
% Growth	*25.6%*	*17.8%*	*23.0%*	*22.1%*	*21.0%*	*22.0%*	*21.7%*	*21.6%*	*21.8%*
Total Non Interest Income	**473**	**457**	**557**	**625**	**719**	**847**	**995**	**1,175**	**1,397**
% Growth	-17%	-3%	22%	12%	15%	18%	17%	18%	19%

- **We see greater risk than SVB expects**

We are of the view that fallout from macro-level actions by the Fed will not only increase industry competition for lower-tier credits but will also weaken the position of those lower-tier corporates themselves. In that sense, not only will cheap funding be more difficult to gather but loan defaults are likely to increase in such an environment. Accordingly, we have taken a more conservative view and expect loan losses to increase 20bps, stabilizing for three years and dropping to 1.8% thereafter.

Loan Losses	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Loan Losses	333	350	403	520	598	684	798	922	1,086
Loan Losses % of Gross Loans	*2.0%*	*1.7%*	*1.7%*	*1.9%*	*1.9%*	*1.9%*	*1.9%*	*1.8%*	*1.8%*

Provision for Losses	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Provisions / Average Gross Loans %	0.65%	0.58%	0.44%	0.58%	0.57%	0.56%	0.56%	0.55%	0.54%
Provision For Loan Losses	96	107	92	145	168	190	225	256	296

- **Efficiency ratio should stay tight but we're not expecting much improvements**

SVB's topline growth has been accompanied by cost-consciousness that has helped the gains accrue to bottomline and drive the faster EPS growth we have seen. Investments in technology has helped cost-to-income ratio moderate to about 50% over the last five years. Whilst we don't see any particular reason for the ratio to deteriorate, we also don't see scope for much improvement. We forecast a stable 50bps improvement over the next six year.

Total Non Interest Expenses	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Revenue Before Losses	1,479	1,607	1,978	2,518	3,147	3,658	4,249	4,945	5,766
Cost to Income Ratio	*52.7%*	*53.5%*	*51.1%*	*51.8%*	*51.3%*	*50.8%*	*50.3%*	*49.8%*	*49.3%*
Total Non Interest Expense	780	860	1,011	1,303	1,613	1,857	2,136	2,461	2,840

- **Future growth constraint by capital requirement**

Regulatory rules require that loan growth is supported by improved capital levels. Management expects that, given their strong growth forecast for loan balances and the newly implemented deposit strategies, the majority of earnings capital generated will be used to fund balance sheet growth going forward. It is against this backdrop that we maintain management guidance of an average 7 to 8% leverage ratio.

Capital Levels	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Tier 1 Capital	3,325	3,745	4,247	4,132	4,760	5,491	6,337	7,317	8,453
Average Total Assets	42,012	44,685	47,949	55,087	63,471	73,210	84,487	97,556	112,705
Tier 1 Leverage Ratio	7.9%	8.4%	8.9%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Basel III Minimum Required	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*

Capital Balance Account	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Beginning Tier 1 Capital	4,247	4,132	4,760	5,491	6,337	7,317
Net Income	770	983	1,160	1,360	1,605	1,894
Less: Pref Div	-	-	-	-	-	-
Addition/(Distribution)	(885)	(354)	(429)	(514)	(624)	(757)
Ending Tier 1 Capital	4,132	4,760	5,491	6,337	7,317	8,453

- **Key Financial Ratios**

Financial Ratios	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
Net Interest Margin	2.56%	2.72%	3.04%	3.51%	3.86%	3.81%	3.77%	3.71%	3.65%
Return on Avg Assets	0.89%	0.87%	1.08%	1.40%	1.55%	1.58%	1.61%	1.64%	1.68%
Return on Avg Equity	10.15%	10.98%	12.82%	18.07%	21.75%	22.31%	22.72%	23.26%	23.79%
Effective Tax Rate	37.9%	39.1%	40.6%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%

Valuation

We determined the cost of equity using the Capital Asset Pricing Model (CAPM). Our proxy for the risk-free rate is the 10-year treasury at 2.97%. Our beta estimate is the 5-year average beta of 1.41 from S&P capital IQ. We applied a 2.3% terminal growth rate which is the mid-point of the long-term U.S. GDP forecast, and an equity risk premium of 4.95% (from A. Damodaran's historical equity risk premium database). Our estimate for cost of equity is 9.9%.

Using the discounted cashflow model, where cashflows discounted are the distributable income after transfer into Common Equity Tier 1 capital, we arrived at an implied price of $162.9 indicating an 88% Overvaluation and 41.6% downside to our 12-month target of $178.55.

	2018E	2019E	2020E	2021E	2022E	2023E	Terminal
Year Fraction	*0.67*	*1.67*	*2.67*	*3.67*	*4.67*	*5.67*	
Beginning Tier 1 Capital	4,247	4,132	4,760	5,491	6,337	7,317	
Required Ending Tier 1 Capital	4,132	4,760	5,491	6,337	7,317	8,453	
Change in Tier 1 Capital	**(115)**	**629**	**730**	**846**	**980**	**1,136**	
Net Income	770	983	1,160	1,360	1,605	1,894	
Less: Pref Dividend	-	-	-	-	-	-	
Less: Change in Tier 1 Capital	115	(629)	(730)	(846)	(980)	(1,136)	
Distributable Income to Equity	**885**	**354**	**429**	**514**	**624**	**757**	**10,128**
Discount Factor	*0.9387*	*0.8538*	*0.7765*	*0.7062*	*0.6423*	*0.5842*	
Discounted Distributions	**831**	**302**	**333**	**363**	**401**	**442**	**5,917**

Implied Valuation	**8,591**
Shares Outstanding	52.90
Implied Price per share	**162.39**
Current Price	305.82
(Under)/Over Valuation	88.3%
12 Month Target	**178.55**
Upside from Current Price	-41.6%

Summary Financials

Summary Income Statement												
Values in $m	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**
Interest Income On Loans	469	542	611	693	834	1,026	1,316	1,677	1,957	2,285	2,669	3,119
Interest Income On Investments	180	187	281	354	359	439	639	890	1,023	1,177	1,353	1,556
Total Interest Income	649	730	892	1,047	1,193	1,465	1,955	2,567	2,981	3,462	4,023	4,676
Interest On Deposits	(7)	(9)	(12)	(5)	(6)	(9)	(33)	(76)	(95)	(117)	(144)	(176)
Total Interest On Borrowings	(24)	(23)	(23)	(35)	(37)	(36)	(29)	(63)	(76)	(91)	(109)	(131)
Total Interest Expense	**(31)**	**(32)**	**(35)**	**(40)**	**(43)**	**(45)**	**(62)**	**(139)**	**(170)**	**(208)**	**(253)**	**(307)**
Net Interest Income	**618**	**697**	**857**	**1,006**	**1,151**	**1,420**	**1,892**	**2,428**	**2,810**	**3,254**	**3,770**	**4,369**
Service Charges On Deposits	33	36	40	47	53	59	68	76	87	98	112	127
Credit Card Fee	25	32	42	57	68	77	94	111	131	157	186	221
Gain (Loss) On Sale Of Assets (Rev)	4	-	(14)	-	-	-	-	-	-	-	-	-
Gain on Sale of Invest. & Secur (Rev)	141	466	338	160	90	119	94	84	84	75	70	66
Other Non-Interest Income	132	139	166	209	246	303	370	447	546	664	808	984
Total Non Interest Income	**336**	**673**	**572**	**473**	**457**	**557**	**625**	**719**	**847**	**995**	**1,175**	**1,397**
Revenue Before Losses	**953**	**1,371**	**1,429**	**1,479**	**1,607**	**1,978**	**2,518**	**3,147**	**3,658**	**4,249**	**4,945**	**5,766**
Provision For Loan Losses	(44)	(64)	(59)	(96)	(107)	(92)	(145)	(168)	(190)	(225)	(256)	(296)
Operating Income	**909**	**1,307**	**1,369**	**1,384**	**1,500**	**1,885**	**2,373**	**2,978**	**3,468**	**4,024**	**4,689**	**5,470**
Total Non-Interest Expense	(546)	(615)	(707)	(780)	(860)	(1,011)	(1,303)	(1,613)	(1,857)	(2,136)	(2,461)	(2,840)
Pre Tax Income	**363**	**692**	**662**	**604**	**641**	**875**	**1,070**	**1,365**	**1,611**	**1,889**	**2,229**	**2,630**
Income Tax Expense	(113)	(147)	(184)	(229)	(250)	(355)	(299)	(382)	(451)	(529)	(624)	(736)
Net Income	**250**	**545**	**479**	**375**	**390**	**519**	**770**	**983**	**1,160**	**1,360**	**1,605**	**1,894**

Source: Financial and Market Data from S&P Capital IQ as of May 4, 2018

Summary Balance Sheet

Values in $m	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
Total Investments	12,802	13,956	22,995	26,290	21,997	25,124	28,893	33,226	38,210	43,942	50,533	58,113
Gross Loans	9,024	10,995	14,488	16,857	20,025	23,254	27,104	31,610	36,886	43,068	50,313	58,809
Loan Losses	(188)	(232)	(269)	(333)	(350)	(403)	(520)	(598)	(684)	(798)	(922)	(1,086)
Net Loan	8,836	10,763	14,219	16,524	19,675	22,851	26,584	31,013	36,203	42,270	49,391	57,723
Goodwill and Other Intangibles	-	-	-	-	-	-	-	-	-	-	-	-
Other Assets	1,128	1,698	2,124	1,872	3,012	3,239	3,482	3,743	4,024	4,326	4,650	4,999
Total Assets	**22,766**	**26,417**	**39,338**	**44,687**	**44,684**	**51,214**	**58,959**	**67,982**	**78,437**	**90,538**	**104,574**	**120,836**
Interest Bearing Deposits	5,301	6,579	9,760	8,275	7,004	7,599	11,229	14,007	17,366	21,418	26,295	32,153
Non-Interest Bearing Deposits	13,875	15,894	24,584	30,867	31,975	36,655	36,345	40,702	45,549	50,934	56,910	63,533
Total Deposits	**19,176**	**22,473**	**34,343**	**39,143**	**38,980**	**44,254**	**47,573**	**54,709**	**62,915**	**72,353**	**83,206**	**95,687**
Total Borrowings	637	474	490	1,602	1,373	1,838	5,513	6,616	7,939	9,527	11,433	13,719
Other Liabilities	347	391	452	608	554	803	1,668	1,824	2,019	2,248	2,546	2,904
Total Liabilities	**20,161**	**23,338**	**35,286**	**41,353**	**40,907**	**46,895**	**54,755**	**63,149**	**72,873**	**84,128**	**97,185**	**112,310**
Total Common Equity	**2,605**	**3,079**	**4,052**	**3,333**	**3,777**	**4,319**	**4,204**	**4,833**	**5,564**	**6,409**	**7,390**	**8,526**
Preferred Equity	-	-	-	-	-	-	-	-	-	-	-	-
Total Equity	**2,605**	**3,079**	**4,052**	**3,333**	**3,777**	**4,319**	**4,204**	**4,833**	**5,564**	**6,409**	**7,390**	**8,526**

Source: Financial and Market Data from S&P Capital IQ as of May 4, 2018

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