

State Bank of India

Headwinds intensify, too early to enter

- We lower our earnings forecast for FY10 by 2.5% to reflect higher bond losses and NPL provisions, and cut our PT by 9% to Rs2,100.
- **Exposed to bond risk:** SBI has increased its AFS duration to 3.5, and that exposes it to significant bond risk. The 10-year bond yield is already up ~40bp qtd to ~8%, and we expect another 25-50bp. SBI's earnings sensitivity to a 100bp increase in bond yields is ~15%. Moreover, the absence of the Rs17B in trading profit (in Apr-Dec 2009) will have an impact on FY11E EPS.
- **Asset quality stress to continue:** SBI's restructured loan portfolio has already started rolling over, and incremental slippage in Apr-Dec 2009 was very high with gross NPAs increasing by 25% over last two quarters. As the portfolio has significant concentration in vulnerable segments such as retail and SME, we believe that delinquencies will continue into 1H FY11. We expect the need to take provision coverage to 70% will also continue to put pressure on provisioning costs.
- **Capital raising a possibility:** We expect SBI to raise capital, probably through a rights issue, in FY11. This is based on a statement made by the Chairman in the post-results press conference in January, as well as the government making budget allocations for capitalising banks.
- **Lowering valuation on near-term earnings pressure:** SBI faces significant near-term earnings pressure from the possibility of higher slippages, high bond risks, and the need for high coverage. We thus now base our PT on 1.35x FY11E book (vs 1.45x FY11E earlier), leading to our 9% PT cut.
- **PT and valuation:** We revise our Mar-11 PT to Rs2,100 (down from Rs2,300 earlier) on lower P/BV multiple. Our PT is based on the Gordon growth model. A key upside risk to our call is lower-than-expected slippages from the restructured book. Pressure to near-term earnings is a downside risk.

Neutral

SBI.BO, SBIN IN

Price: Rs2,065.95

▼ **Price Target: Rs2,100.00**
Previous: Rs2,300.00

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Banks**

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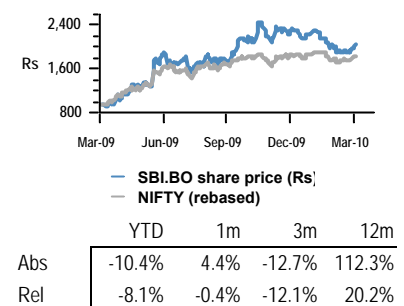
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Price Performance



State Bank of India (Reuters: SBI.BO, Bloomberg: SBIN IN)

Year-end Mar (Rs in mn)	FY08A	FY09A	FY10E	FY11E	FY12E		
Operating Profit	155,404	228,017	223,877	290,052	354,524	52-wk range (Rs)	2,500.00 - 891.50
Net Profit	89,607	109,867	121,650	138,504	165,346	Market cap (Rs mn)	1,311,630
Cash EPS (Rs)	141.90	173.05	191.61	218.16	260.44	Market cap (\$ mn)	28,754
Fully Diluted EPS (Rs)	101.70	158.77	169.35	220.63	262.78	Shares outstanding (mn)	635
DPS (Rs)	11.67	21.38	27.00	35.00	47.00	Fiscal Year End	Mar
EPS growth (%)	17.3%	22.0%	10.7%	13.9%	19.4%	Price (Rs)	2,065.95
ROE	17.3%	16.4%	15.7%	15.7%	16.4%	Date Of Price	08 Mar 10
P/E	14.6	11.9	10.8	9.5	7.9	Avg daily value (Rs mn)	1,279.6
BVPS (Rs)	969.74	1,140.22	1,302.08	1,485.24	1,693.88	Avg daily value (\$ mn)	28.1
P/BV	2.1	1.8	1.6	1.4	1.2	Avg daily vol (mn)	0.9
Div. Yield	0.6%	1.0%	1.3%	1.7%	2.3%	NIFTY	5,124
						Exchange Rate	45.62

Source: Company data, Bloomberg, J.P. Morgan estimates.

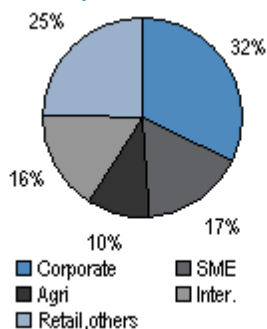
See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company Description

SBI is the largest bank in India, with a 59% government stake. It has a loan book of ~US\$180B with exposure to corporate, SME, retail, international and Agri sectors and forms >25% of total system credit. It has the largest number of branches (>10000) and employee strength.

Loan Break up



Source: Company

EPS: J.P. Morgan vs consensus

	J. P. Morgan	Consensus
FY10E	192	179
FY11E	218	222
FY12E	260	272

Source: Bloomberg, J.P. Morgan.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
NIMs		
Impact of each 10bps	5.4%	7.0%
Cost to Income		
Impact of each 100bps	3.2%	4.2%
Provisions/Assets		
Impact of each 10bps	0.0%	7.0%

Source: J.P.Morgan estimates

Price target and valuation analysis

Our price target of Rs2,100 is based upon Gordon growth model assuming terminal growth of 9%, cost of equity of 14.1%, and FY12 ROE of 16% implying P/BV of 1.35x FY11E and Rs107/share of value from the insurance business.

Risk free rate:	7.5%
Market risk premium:	6.0%
Beta:	1.1
Cost of Equity	14.1%
Terminal "g":	5%
Asset/Equity	5.3
Target P/B (FY11 book)	1.35

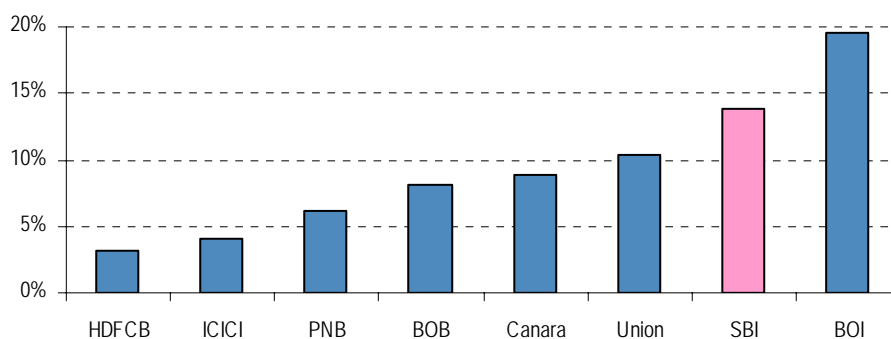
We have lowered our valuation multiple due to near-term risks to profitability. A key upside risk to our call is lower-than-expected slippages from the restructured book. Pressure to near-term earnings is a downside risk.

Figure 1: SBI: Valuation

FY12E ROE	16.4%
COE	14.1%
Growth	5.0%
Implied P/B	1.35
FY11E book	1,485
Bank Valuation	2,009
Insurance valuation	107
Fair Price	2,116
PT	2100

Source: J.P. Morgan estimates

Figure 2: SBI: Bond risk high



Source: Companies, J.P. Morgan estimates.

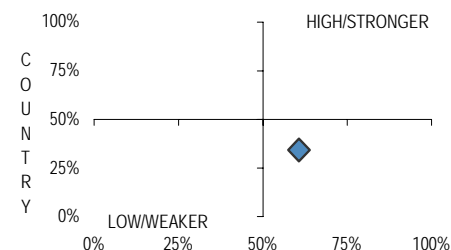
All Data As Of 05-Mar-10

Q-Snapshot: State Bank of India

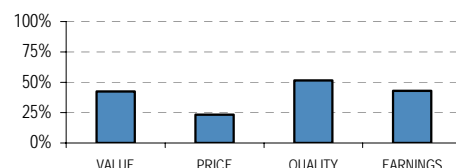
Quant Return Drivers (a Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country	vs Industry	Raw Value
Value			
P/E Vs Market (12mth fwd EPS)	70%	75%	0.7x
P/E Vs Sector (12mth fwd EPS)	57%	70%	0.8x
EPS Growth (forecast)	15%	20%	3.0%
Value Score	42%	56%	
Price Momentum			
12 Month Price Momentum	26%	64%	111.5%
1 Month Price Reversion	39%	45%	1.6%
Momentum Score	23%	63%	
Quality			
Return On Equity (forecast)	42%	78%	16.0%
Earnings Risk (Variation in Consensus)	63%	67%	0.09
Quality Score	52%	81%	
Earnings & Sentiment			
Earnings Momentum 3mth (risk adjusted)	37%	36%	-2.3
1 Mth Change in Avg Recom.	55%	55%	0.03
Net Revisions FY2 EPS	58%	48%	0%
Earnings & Sentiment Score	43%	43%	
COMPOSITE Q-SCORE* (0% To 100%)	34%	61%	

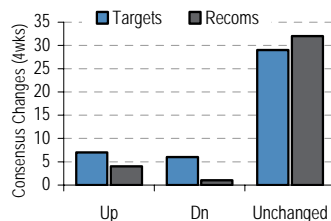
J.P. Morgan Composite Q-Score



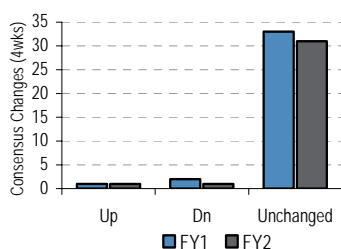
INDUSTRY
Quant Return Drivers Summary (vs Country)



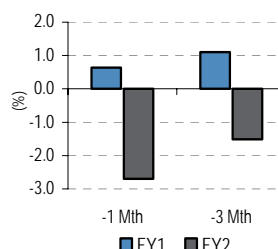
Targets & Recommendations**



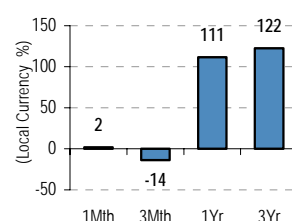
EPS Revisions**



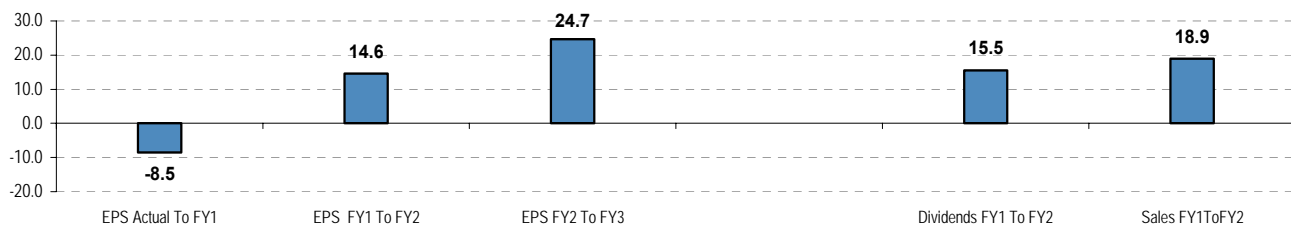
EPS Momentum (%)



Historical Total Return (%)



Consensus Growth Outlook (%)



Closest in Country by Size (Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score*
500325-IN	Reliance Industries Ltd.	Oil Refining/Marketing	72,626	130.19	19.3	15%
500312-IN	Oil & Natural Gas Corp. Ltd.	Oil & Gas Production	51,123	20.61	11.3	35%
532555-IN	NTPC Ltd.	Electric Utilities	37,137	17.61	19.4	17%
500209-IN	Infosys Technologies Ltd.	Information Technology Services	33,163	56.17	24.6	49%
532540-IN	Tata Consultancy Services Ltd.	Information Technology Services	32,620	30.44	22.5	86%
500112-IN	State Bank of India	Regional Banks	27,866	100.84	12.8	34%
500103-IN	Bharat Heavy Electricals Ltd.	Electrical Products	26,115	34.61	28.2	54%
532454-IN	Bharti Airtel Ltd.	Wireless Telecommunications	24,082	55.22	12.4	17%
507685-IN	Wipro Ltd.	Information Technology Services	22,274	18.00	22.4	71%
532174-IN	ICICI Bank Ltd.	Regional Banks	21,999	87.81	25.2	36%
500510-IN	Larsen & Toubro Ltd.	Trucks/Construction/Farm Machinery	20,559	52.48	27.9	22%

Source: Factset, Thomson and J.P. Morgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/qsnapshot/>
Q-Snapshots are a product of J.P. Morgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'
Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the J.P. Morgan analysts' recommendation.
* The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe. ** The number of up, down and unchanged target prices, recommendations or EPS forecasts that make up consensus.

State Bank of India: Summary of Financials

Income Statement						Growth Rates					
Rs in millions, year end Mar	FY08	FY09	FY10E	FY11E	FY12E		FY08	FY09	FY10E	FY11E	FY12E
NIM (as % of avg. assets)	2.7%	2.6%	2.4%	2.4%	2.5%	Loans	23.8%	24.4%	20.0%	22.0%	18.0%
Earning assets/assets	94.6%	94.9%	95.7%	95.8%	95.9%	Deposits	18.2%	25.0%	11.0%	24.2%	20.4%
Margins (% of earning assets)	2.6%	2.5%	2.3%	2.3%	2.4%	Assets	26.0%	27.0%	12.1%	27.4%	17.5%
						Equity	44.0%	18.2%	14.2%	14.1%	14.0%
Net Interest Income	235,943	290,719	313,322	389,308	479,290	RWA	39.3%	24.3%	18.5%	21.9%	17.5%
Total Non-Interest Income	158,893	203,015	234,901	291,464	340,058	Net Interest Income	8.5%	23.2%	7.8%	24.3%	23.1%
Fee Income	-	-	-	-	-	Non-Interest Income	36.1%	27.8%	15.7%	24.1%	16.7%
Dealing Income	-	-	-	-	-	of which Fee Grth	-	-	-	-	-
Other Operating Income	-	-	-	-	-	Revenues	22.0%	30.3%	11.1%	29.8%	18.2%
Total operating revenues	394,836	493,734	548,223	680,772	819,348	Costs	19.7%	11.0%	22.1%	20.5%	19.0%
Operating costs	-239,432	-265,717	-324,346	-390,720	-464,824	Pre-Provision Profits	15.9%	46.7%	-1.8%	29.6%	22.2%
Pre-Prov. Profits	155,404	228,017	223,877	290,052	354,524	Loan Loss Provisions	21.3%	38.2%	-35.3%	58.9%	33.4%
Provisions	-43,410	-60,001	-38,831	-61,709	-82,313	Pre-Tax	-	-	-	-	-
Other Inc/Exp.	25,389	9,068	14,131	-1,571	-1,489	Attributable Income	40.7%	22.6%	10.7%	13.9%	19.4%
Exceptionals	-2,522	-2,178	-5,069	-5,771	-6,889	EPS	17.3%	22.0%	10.7%	13.9%	19.4%
Disposals/ other income	-	-	-	-	-	DPS	-16.7%	83.3%	26.3%	29.6%	34.3%
Pre-tax	137,383	177,085	199,178	226,772	270,721	Balance Sheet Gearing					
Tax	-47,776	-67,218	-77,528	-88,269	-105,375	Loan/deposit	77.7%	74.1%	80.1%	75.3%	75.2%
Minorities	-	-	-	-	-	Investment/assets	26.5%	23.4%	23.1%	19.5%	14.5%
Other Distbn.	-	-	-	-	-	Loan/Assets	58.7%	57.5%	61.6%	58.9%	59.2%
Attributable Income	89,607	109,867	121,650	138,504	165,346	Customer deposits/liab.	75.6%	77.6%	76.9%	78.3%	78.7%
						LT debt/liabilities	6.4%	5.0%	4.8%	4.7%	4.5%
Per Share Data Rs						Asset Quality/Capital					
EPS	141.90	173.05	191.61	218.16	260.44	Loan loss reserves/loans	0.0%	0.0%	0.0%	0.0%	0.0%
DPS	11.67	21.38	27.00	35.00	47.00	NPLs/loans	2.6%	2.6%	2.8%	2.7%	2.8%
Payout	8.2%	12.4%	14.1%	16.0%	18.0%	Loan loss reserves/NPLs	0.0%	0.0%	0.0%	0.0%	0.0%
Book value	891.74	1,019.27	1,179.99	1,485.24	1,693.88	Growth in NPLs	-39.4%	24.4%	27.1%	17.8%	22.3%
Fully Diluted Shares	631.47	634.88	634.88	634.88	634.88	Tier 1 Ratio	8.2%	9.1%	8.0%	6.9%	6.7%
						Total CAR	12.4%	13.6%	11.9%	10.4%	9.9%
Key Balance sheet Rs in millions						Du-Pont Analysis					
Net Loans	6,032,219	7,503,624	9,004,349	10,985,305	12,962,660	NIM (as % of avg. assets)	2.7%	2.6%	2.4%	2.4%	2.5%
LLR	0	0	0	0	0	Earning assets/assets	94.6%	94.9%	95.7%	95.8%	95.9%
Gross Loans	6,032,219	7,503,624	9,004,349	10,985,305	12,962,660	Margins (as % of Avg. Assets)	2.6%	2.5%	2.3%	2.3%	2.4%
NPLs	157,441	195,845	248,866	293,283	358,825	Non-Int. Rev./ Revenues	40.2%	41.1%	42.8%	42.8%	41.5%
Investments	2,720,000	3,056,892	3,380,663	3,641,329	3,177,544	Non IR/Avg. Assets	1.7%	1.7%	1.7%	1.8%	1.7%
Other earning assets	565,146	517,467	574,985	746,133	879,377	Revenue/Assets	3.8%	3.8%	3.7%	3.7%	3.7%
Avg. IEA	8,711,880	11,069,738	13,241,776	15,929,913	19,429,303	Cost/Income	60.6%	53.8%	59.2%	57.4%	56.7%
Goodwill	-	-	-	-	-	Cost/Assets	2.6%	2.3%	2.3%	2.3%	2.3%
Assets	10,272,695	13,048,257	14,625,769	18,635,675	21,902,266	Pre-Provision ROA	6.4%	6.1%	6.1%	6.0%	6.0%
Deposits	7,764,165	10,119,883	11,244,729	14,591,807	17,247,628	LLP/Loans	-0.7%	-0.8%	-0.4%	-0.6%	-0.6%
Long-term bond funding	660,232	645,916	700,910	868,998	995,209	Loan/Assets	59.2%	58.0%	59.7%	60.1%	59.1%
Other Borrowings	-	-	-	-	-	Other Prov, Income/ Assets	0.3%	0.1%	0.1%	-0.0%	-0.0%
Avg. IBL	7,636,872	9,595,098	11,355,719	13,703,222	16,851,821	Operating ROA	1.7%	2.0%	1.6%	1.7%	1.7%
Avg. Assets	9,212,220	11,660,476	13,837,013	16,630,722	20,268,970	Pre-Tax ROA	6.3%	5.7%	5.9%	5.7%	5.7%
Common Equity	612,364	723,904	826,664	942,946	1,075,409	Tax rate	-	-	-	-	-
RWA	7,795,267	9,691,824	11,484,319	13,999,732	16,451,895	Minorities & Outside Distbn.	0.0%	0.0%	0.0%	0.0%	0.0%
Avg. RWA	6,694,744	8,743,545	10,588,071	12,742,025	15,225,813	ROA	1.0%	0.9%	0.9%	0.8%	0.8%
						RORWA	1.3%	1.3%	1.1%	1.1%	1.1%
						Equity/Assets	5.6%	5.7%	5.6%	5.3%	5.0%
						ROE	17.3%	16.4%	15.7%	15.7%	16.4%

Source: Company reports and J.P. Morgan estimates.

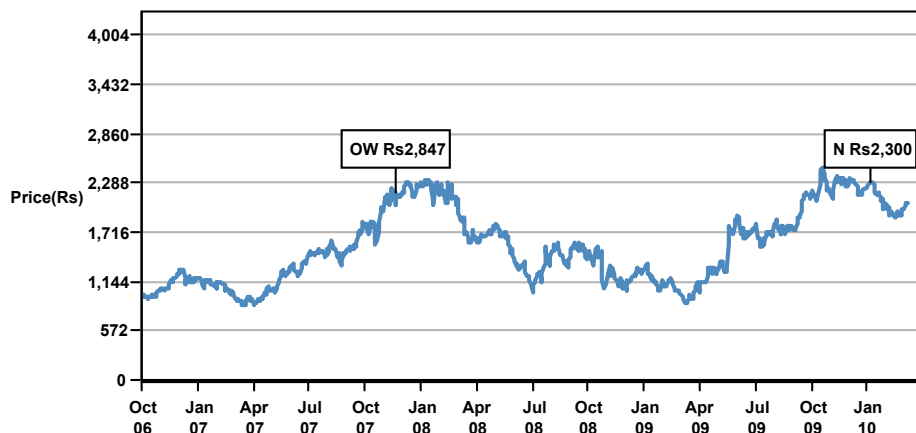
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State Bank of India (SBI.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
20-Nov-07	OW	2174.72	2847.00
06-Jan-10	N	2292.05	2300.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage Feb 26, 2004 - Jun 30, 2004. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	58%	57%	42%
JPMSI Equity Research Coverage	41%	49%	10%
IB clients*	78%	73%	57%

*Percentage of investment banking clients in each rating category.

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