Company Flash

15 January 2008 | 7 pages

State Bank of India (SBI.BO)

Buy: New Capital, and Some Old Liabilities

- **Rights offering – Details, and a discounted price**— SBI has finalized terms of its rights offering; these are a) 20% new stock – one share for every five held for all investors, including GDR holders, b) price of Rs1590 per share – a discount of about 35% to current stock price, and c) 0.7% ESOP offering – details being firmed up, but a first for SBI and the government banking sector. SBI seeks to complete transaction by March end – procedurally, could get pushed back.

- **Bolster Tier 1 to about 11%, dilute earnings 5%** — SBI's capital raising - Rs167b; should expand capital base 45% - and raise Tier 1 capital to about 11% (March 08). Should dilute earnings about 5% (FY09, without leverage), given large discount to the market price. The government will maintain its 59%+ stake – though it will invest in the form of government bonds (liquid, and market yielding), rather than cash. The record date is 4 February.

- **A third of new capital to plug pension liabilities?** — We believe SBI could use the new capital to almost immediately plug its pension liability hole – potentially about Rs57b. If so, would absorb over a third of the new capital, offset at balance-sheet level, and would limit Tier 1 increase to under 10%. Effectively, free capital raised by SBI will be less than the headline number, given the existing, and quasi recognized/quantified pension liability.

- **Capital block going - Should hold for the rest of the government banking sector** — Key positive; potential capital block because of government ownership constraints appears addressed. We believe a similar capital funding mechanism should logically apply to other government banks; a positive.

Buy/Low Risk	**1L**
Price (15 Jan 08)	Rs2,414.35
Target price	Rs2,430.00
Expected share price return	0.6%
Expected dividend yield	0.7%
Expected total return	**1.3%**
Market Cap	Rs1,270,670M US$32,337M

Price Performance (RIC: SBI.BO, BB: SBIN IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	44,067	83.78	2.4	28.8	4.6	17.1	0.6
2007A	45,414	86.31	3.0	28.0	4.1	15.4	0.6
2008E	54,018	102.64	18.9	23.5	3.6	16.1	0.7
2009E	63,778	121.18	18.1	19.9	3.1	16.6	0.7
2010E	76,209	144.80	19.5	16.7	2.7	17.2	0.7

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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State Bank of India

Company description

SBI is India's largest bank with around 20% market share in deposits and loans, 9,038 branches and more than 90m customers. Together with its seven associate banks (ownership ranging from 75% to 100%), the SBI group has more than 26% market share in deposits and 24% in loans, and has 13,635 branches. SBI has the largest overseas presence among Indian banks, with 54 offices in 28 countries. The Reserve Bank of India owns 59.73% of the bank. SBI is a banker to most state governments, and has a dominant share of government fee business. SBI has a presence in other financial services through subsidiaries and joint ventures. It has a joint venture with Cardiff for life insurance and with GE Capital for credit cards. It also has a presence in asset management, investment banking and primary dealership. The SBI group has more than 6000 ATMs spread, the largest in the country. The bank has more than 28m cards outstanding, is networked across over 10,000 offices of the SBI group and is aggressively expanding its technology based offering, across is existing network.

Investment strategy

We rate SBI Buy (1L). SBI has aggressively restructured in terms of manpower, technology and business focus. It should be a significant beneficiary of the expected increase in loan demand in India, spread across the consumer sector and in the industrial segment. SBI appears to have sustainable ROEs of 15-17%.

Valuation

Our target price for SBI is Rs2430 (previously Rs1825) is based on our EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for Citi's India Banking universe. We use a risk-free rate of 8% in line with the market level and value the company's subsidiaries at Rs645 (previously Rs525) based on valuation benchmarks for FY09E and after factoring in the Insurance and asset management business. Our target price upgrade is premised on higher subsidiary valuation (Insurance at Rs241 per share and associate banks at 1.5X PBV), higher longer term expectations for fee income growth, asset yields and lower costs than our previous valuation.

Our valuation for SBI is also benchmarked off a P/BV of 2x FY09E for the parent (1.5x previously) and 1.5x FY09E (1.25X FY09E, previously) for the associate banks, and we factor in Rs241 (Rs140 previously) per share for the Insurance company, and Rs15 for the Asset management companies. This translates to a value of Rs2000 per share. We are basing our target price on EVA as P/BV for the consolidated entity will require more consistent and predictable reporting by management. We are also consistently using the EVA measure as our primary methodology as we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business.

Risks

We rate SBI Low Risk based on our quantitative risk-rating system. The downside risks to our target price lie in: (1) A sharp rise in interest rates; (2) Asset quality concerns given strong loan growth; (3) lack of liquidity or deposit growth; (4) government involvement could be contrary to the interests of minority shareholders; and (5) a lack of capital to support growth.

Appendix A-1

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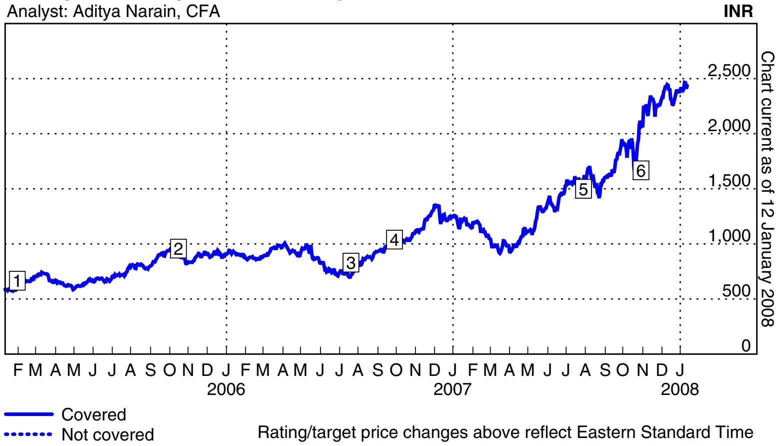
State Bank of India (SBI.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



Rating/target price changes above reflect Eastern Standard Time

#	Date	Rating	Target Price	Closing Price
1:	31 Jan 05	1L	*790.00	642.80
2:	17 Oct 05	1L	*1,110.00	924.30
3:	20 Jul 06	1L	*950.00	725.75
4:	28 Sep 06	1L	*1,235.00	1,028.85
5:	29 Jul 07	1L	*1,825.00	1,579.00
6:	30 Oct 07	1L	*2,430.00	2,062.20

*Indicates change.

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% of companies in each rating category that are investment banking clients	52%	53%	40%

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