

Company Flash

11 October 2007 | 7 pages

State Bank of India (SBI.BO)

Cutting Rates – But the Wrong Ones?

- Cutting mortgage, retail rates by 50-100bps** — These reductions take immediate effect and are on offer for only new loans during the festive season (until end-Dec). The cuts do not cover existing floating-rate loans and follow more modest cuts by other banks, which have also made limited-period offers for new loans.
- Triggered by slower industry growth** — Likely drivers of this cut were: a) moderating industry loan growth (particularly retail); growth is down to 23% yoy from 30%+ in Jan 07; and b) incremental loan/deposit for the system is 35% YTD, implying that banks have surplus funds. A possible reason could be the finance minister's recent suggestion that mortgage rates be lowered, but that remains conjectural.
- In line with SBI's stated policy to gain market share** — SBI's Chairman has been fairly explicit on the bank's intention to regain market share. SBI achieved this goal last year. Its current pricing stance — aggressive on assets and deposits — appears geared to supporting this strategy, with possible risk to profitability.
- Is SBI cutting the wrong rates; deposit rate cuts should lead lending rate cuts** — We believe SBI should rather cut deposit rates first to better balance loan-deposit growth, allow for slower re-pricing of deposits to protect margins, and better position itself for a lower rate environment. We see aggressive deposit rate cuts as a key stock catalyst; standalone loan rate cuts are likely a drag.

Buy/Low Risk	1L
Price (10 Oct 07)	Rs1,923.85
Target price	Rs1,825.00
Expected share price return	-5.1%
Expected dividend yield	0.8%
Expected total return	-4.3%
Market Cap	Rs1,012,520M US\$25,869M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	44,067	83.78	2.4	23.0	3.7	17.1	0.7
2007A	45,414	86.31	3.0	22.3	3.2	15.4	0.7
2008E	54,018	102.64	18.9	18.7	2.8	16.1	0.8
2009E	63,778	121.18	18.1	15.9	2.5	16.6	0.9
2010E	76,209	144.80	19.5	13.3	2.1	17.2	0.9

Source: Powered by dataCentral

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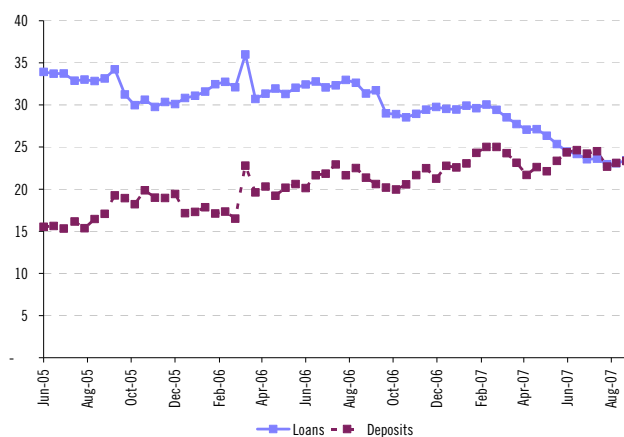
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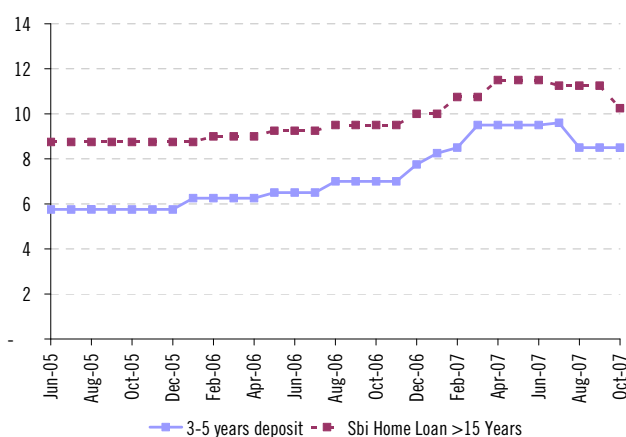
¹Citigroup Global Markets India Private Limited

Figure 1. Sector Loan and Deposit Growth



Source: Citi Investment Research and RBI

Figure 2. SBI — Floating Home Loan Rates/Deposit Rates



Source: Citi Investment Research and Company website

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 its existing network.

Investment strategy

We rate SBI Buy/Low Risk (1L). SBI has aggressively restructured itself 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 Rs1,825 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 Rs525 based on valuation benchmarks for FY09E and after factoring in the insurance and asset-management business. Our valuation for SBI is also benchmarked off a P/BV of 1.5x FY09E for the parent and 1.25x FY0E, for the associate banks, and we factor in Rs150 per share for the Insurance and Asset management Companies. Our target multiples are consistent with the target multiples we are using for other best-in-class government banks, even though we believe they could well be raised higher, given the franchise and qualitative elements of SBI compared with peer banks. We maintain a 25% discount to parent for the associate banks, given scale and concentration risks, and the unlikelihood of SBI selling or merging these businesses in the near term. This corresponds to a fair value of Rs1542. 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

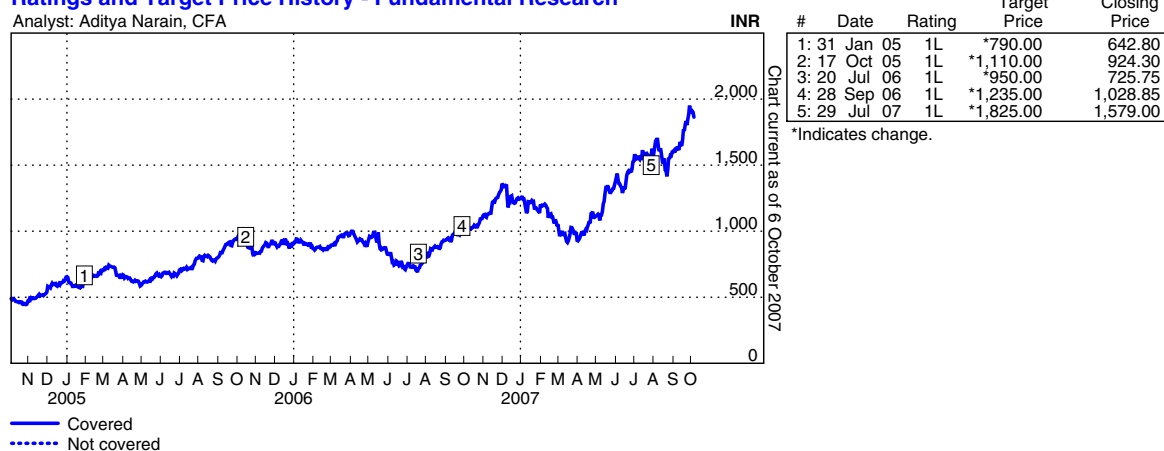
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