

Banking

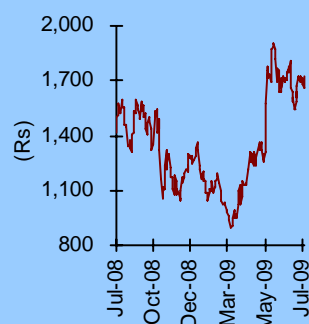
Target price Rs1,660

Shareholding pattern

	Dec '08	Mar '09	Jun '09
Promoters	62.1	62.1	62.1
Institutional investors	26.3	25.3	25.8
MFs and UTI	6.4	5.9	5.3
Insurance Cos.	9.0	11.1	11.1
FIs	10.9	8.3	9.4
Others	11.6	12.6	38.1

Source: BSE

Price chart



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INDIA

State Bank of India

HOLD

Maintained

Rs1,723

Exceeding expectations

Reason for report: Q1FY10 results review

State Bank of India's (SBI) Q1FY10 net profits grew 42% YoY, higher than our expectations, driven by strong 45% YoY rise in core fee income growth and Rs12bn write-back of investment provisions. While NIMs remained under pressure (down 73bps YoY and ~15bps QoQ), this was in line with most banks that reported margin compression due to excess liquidity on the balance sheet. Pre-provisioning profits were down 7.3% YoY given higher operating expenses on the back of Rs6.3bn additional provision for wage revision. Asset quality remained manageable – Dabhol exposure of Rs16.5bn is now upgraded to standard restructured assets. Maintain HOLD. Prolonged margin compression and deterioration in asset quality are the key risks.

- **Balance sheet liquidity rises; NIMs under pressure.** SBI's advances grew 22.5% YoY, while deposits increased 35.9% YoY and ~2.9% QoQ. Excess liquidity deployed in low-yielding assets, BPLR cuts and slow deposits repricing led to compression in NIMs (down 73bps YoY) to 2.3%. NII increased 4.3% YoY (in line with our estimates). We estimate ~20bps YoY compression in NIMs in FY10E.
- **Robust other income growth; one-time items buoy costs.** Other income increased a healthy 48.5% YoY driven by Rs7.1bn trading profits (Rs2.23bn in Q1FY09). Growth in other income (ex-treasury) was healthy at 31.1% YoY. Operating expenses grew 51% YoY, primarily driven by one-time wage provisions of Rs6.29bn owing to increase in estimated liability for wage revision and pension provisions of Rs4.29bn in Q1FY10.
- **Asset quality controlled; no surprises on restructured assets.** SBI marginally improved its asset quality with GNPA's & NNPA's improving 5bps QoQ & 21bps QoQ to 2.79% & 1.55% respectively. SBI's restructured assets were at Rs81.18bn, with Rs16.5bn exposure to Dabhol being a part of the standard restructured assets in Q1FY10. Total outstanding restructured assets, including loans ordinarily restructures, are at Rs211.5bn (3.85% of gross advances). Provisions declined 88.9% YoY due to Rs12bn write-back in investment depreciation. Provision coverage ratio improved to 45.2% QoQ in Q1FY10 from 38.72% in Q4FY09.
- **Healthy performance by subsidiaries; maintain HOLD.** SBI Group's consolidated net profit grew an impressive 68.11% YoY. We marginally adjust earnings to account for traction in core-fee income and write-back of investment depreciation. But margin pressure is likely to keep RoE subdued at 16% through FY11E. At the current market price, the stock trades at FY11E P/E & P/BV of 6.9x & 1.1x. Prolonged NIM compression and sharp deterioration in NPA are key risks.

Market Cap	Rs1088bn/US\$27.5bn
Reuters/Bloomberg	SBI.BO/SBIN IN
Shares Outstanding (mn)	634.9
52-week Range (Rs)	2040/892
Free Float (%)	37.9
FII (%)	9.4
Daily Volume (US\$/000)	103,690
Absolute Return 3m (%)	26.1
Absolute Return 12m (%)	21.6
Sensex Return 3m (%)	26.8
Sensex Return 12m (%)	7.2

Year to March	2008	2009	2010E	2011E
NII (Rs mn)	170.2	208.7	243.9	297.4
Net Profit (Rs mn)	67.3	91.2	96.1	113.5
EPS (Rs)	116.2	144.1	151.4	178.8
% Chg YoY	34.7	23.9	5.1	18.1
P/E (x)	10.7	8.6	8.2	6.9
P/BV (x)	1.7	1.5	1.3	1.1
Net NPA (%)	1.8	1.8	1.7	1.6
Dividend Yield (%)	1.2	1.7	1.8	2.1
RoA (%)	1.0	1.1	0.9	0.9
RoE (%)	16.8	17.1	15.6	16.2

Please refer to important disclosures at the end of this report

Balance sheet liquidity rises; NIMs under pressure

SBI's advances grew 22.5% YoY – while corporate and SME advances have slowed down sequentially, retail advances are still growing at a healthy 5.5% QoQ or 22.5% YoY (Table 1). On the other hand, deposits increased a robust 35.9% YoY and ~2.9% QoQ. Considering that SBI still has large amount of bulk deposits (Rs400bn mobilised as 1,000-day deposits at a blended cost of ~9.75%) on its balance sheet, which are yet to reprice, the strategy of continuing deposit mobilisation with stagnant advances is likely to weigh on its margins. We envisage a pick-up in advances growth in the ensuing quarters and peg our expectations at 21% advances CAGR through FY11E.

Table 1: Sequential slowdown in corporate advances; retail healthy

(Rs mn)

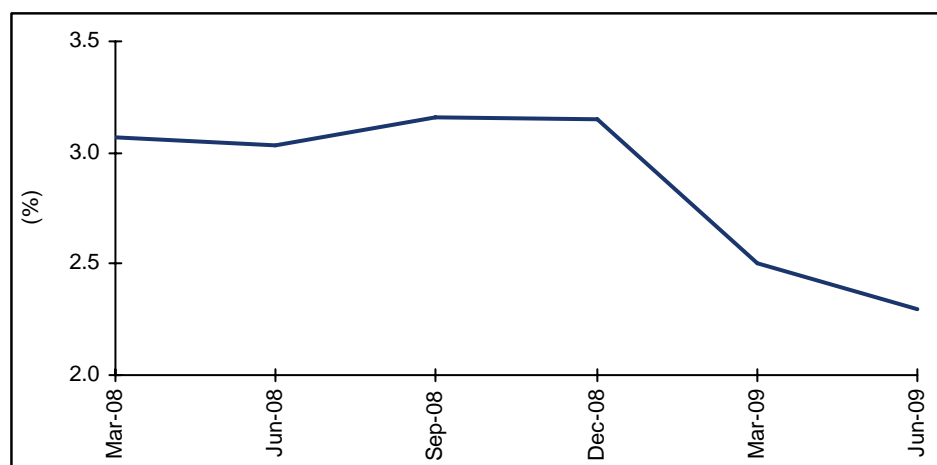
	Q1FY10	% YoY	% QoQ
Retail advances	1,129	22.5	5.5
Home loans	575	24.0	6.4
Auto	104	29.0	7.1
Education	72	40.5	8.2
PLs	378	16.0	3.4
Large corporate	673	36.5	(2.3)
Mid corporate	1,190	15.0	(5.5)

Source: Company data

Margins under strain as advances stagnate; expect a slow recovery

Margins continued to be under pressure as advances growth stagnated and additional resources mobilised (Rs215bn in Q1FY10) were deployed in low-yielding investments. Margins also took the brunt of ~125bps cumulative reduction in PLR in the past two quarters as deposits reprice slower. Yield on advances rose 21bps YoY to 10.01%; however, yield on resources deployed was lower 94bps YoY and cost of deposits higher 45bps YoY to 6.16%. This resulted in 73bps YoY (an estimated ~20bps QoQ) compression in NIM to 2.3% in Q1FY10. NII growth of 4.3% YoY was largely in line with our estimates.

As balance sheet liquidity remains high, with steady deposits mobilisation not matched by corresponding deployment in advances, margins are likely to remain under pressure in our view. We expect a slow recovery in margins as high-cost deposits mature over the ensuing quarters and credit growth picks up. Nevertheless, NIMs are likely to compress ~20bps YoY in FY10E. We maintain our estimated NII CAGR of 19.4% through FY11E.

Chart 1: NIMs compress in recent quarters

Source: I-Sec Research, Company data

Robust other income growth; one-time items buoy costs

Other income rose a healthy 48.5% YoY driven by Rs7.1bn trading profits (Rs2.23bn in Q1FY09). Growth in other income (ex-treasury) was healthy as well at 31.1% YoY. Prime contributors to strong other income growth were core fee income and profit on exchange transactions, each rising 44.9% and 178% YoY respectively (Table 2).

Table 2: Strong performance in core-fee income*(Rs mn)*

	Jun-08	Jun-09	% YoY
Commission, Exc. Brokerage	12.85	18.62	44.9
Profit on sale of investments	2.23	7.09	218.1
Forex income	1.69	4.70	178.0
Dividend	3.85	3.58	(7.0)
Income from leasing	0.09	0.07	(20.0)
Others other income	3.32	1.62	(51.3)
Total	24.04	35.69	48.5

Source: Company data

Growth in operating expenses was much higher than our estimates of 51% YoY, primarily driven by the presence of one-time wage provisions of Rs6.29bn for an increase in estimated liability during November '07-March '09 for wage revision. Staff costs also contained an additional provision of Rs1.38bn for wage revision, taking the cumulative provision for wage revision in the quarter to Rs7.67bn. SBI also provided Rs4.29bn for pension contribution in employee expenses. As a result, employee expenses increased 60.1% YoY. Adjusting for these, operating costs rose 14.3% YoY. Cost-to-income was at 57.2% for Q1FY10; normalising for non-recurring items, cost-to-income was 47.2%.

Asset quality controlled; no surprises on restructured assets

SBI restructured Rs81.18bn worth of assets in Q1FY10 (of pending restructured assets of Rs109.51 as on March 31, '09). Of this, Rs20.99bn was NPA, while the remaining Rs60.19bn was standard assets. The bank also upgraded its Rs16.5bn exposure to Dabhol to standard restructured assets, which were a part of Rs81.18bn restructured in the quarter. Thus, total outstanding restructured assets, including loans ordinarily restructured, were at Rs211.5bn (including Rs108.4bn outstanding restructured assets as on March 31, '09), which formed 3.85% of gross advances. This was largely in line with our expectations, with the bank controlling additional restructuring within the pending amount indicated as of end-FY09.

SBI marginally improved its asset quality, with GNPA's and NNPA's improving 5bps QoQ and 21bps QoQ respectively to 2.79% and 1.55% respectively. Although on a reported basis, GNPA's declined Rs2.7bn QoQ, this was on account of Rs20.99bn NPAs, now a part of restructured assets and Rs16.5bn exposure to Dabhol being upgraded to standard restructured assets in Q1FY10. Provision coverage ratio improved sequentially to 45.2% in Q1FY10 (from a low of 38.72% in Q4FY09).

Overall provisions stood at Rs1.73bn despite loan loss provisions of Rs12.34bn on account of Rs12bn write-back in investment depreciation (compared with a charge of Rs16.57bn in Q1FY09).

Table 3: Provisions increase owing to write-backs

(Rs mn)

	Jun-08	Jun-09	% YoY
Loan Loss Provisions	(2.47)	12.34	51.7
Investment Depreciation	16.57	(12.01)	(598.9)
Standard Assets	0.36	0.14	(172.5)
Other Provisions	1.04	1.25	(61.4)
Total	15.49	1.73	(88.9)

Source: Company data

Healthy performance by subsidiaries; maintain HOLD

The SBI Group's consolidated net profit grew an impressive 68.11% YoY, with increase in the share of non-interest income to 54.4% of the total income (from 34.4% in Q1FY09). Associate banks' bottomline grew 159.2% YoY. SBI Life reported new business premium of Rs15.68bn in Q1FY10 as against Rs13.85bn in Q1FY09, a growth of 13.2% YoY. It also posted net profits of Rs390mn in Q1FY10 versus loss of Rs500mn in Q1FY09. SBI MFs' AUMs stood at Rs340.6bn in Q1FY10, with the company reporting Rs141.4mn profits in Q1FY10. Overall, the subsidiaries and associates reported a profitable quarter.

SBI's standalone NII growth of 4.3% was largely in line with our estimates; however, traction in core fee income surprised on the upside. We maintain our NII growth CAGR of 19.4% through FY11E, with margin likely to contract ~20bps YoY. With no negative surprises on the asset quality, we maintain our loan loss provision estimates and largely maintain our earnings estimates.

Capital adequacy remains comfortable at 14.12% (tier I at 9.69%). Given our expectations of slow margin recovery in the ensuing quarters, we expect SBI's RoE to

be subdued at ~16% through FY11E. At the current market price, the stock trades at FY11E P/E and P/BV of 6.9x and 1.1x respectively. Maintain HOLD. Low traction in asset growth and sharp deterioration in NPA are the key risks.

Table 4: Q1FY10 results review

(Rs mn, Year ending March 31)

	Q1FY10	Q1FY09	% YoY	Q4FY09	% QoQ	FY09	FY08	% YoY
Interest income	174.7	138.0	26.6	173.4	0.8	647.4	489.5	32.3
Interest expense	124.5	89.8	38.6	125.0	(0.4)	438.7	319.3	37.4
Net interest income	50.2	48.2	4.3	48.4	3.8	208.7	170.2	22.6
Non-interest income	35.7	24.0	48.5	47.2	(24.4)	126.9	86.9	46.0
Total income	85.9	72.2	19.0	95.6	(10.1)	335.6	257.2	30.5
Staff cost	34.1	21.3	60.1	23.5	45.2	97.5	77.9	25.2
Other op expenses	15.1	11.3	33.7	19.3	(22.0)	59.0	48.2	22.4
Total op expenses	49.2	32.6	51.0	42.8	14.9	156.5	126.1	24.1
Pre-provisioning profit	36.7	39.6	(7.3)	52.8	(30.4)	179.1	131.1	36.7
Total Provisions	1.7	15.5	(88.9)	13.8	(87.5)	37.3	26.7	40.0
PBT	35.0	24.1	45.1	39.0	(10.2)	141.8	104.4	35.8
Tax	11.7	7.7	51.7	11.6	1.2	50.6	37.1	36.4
PAT	23.3	16.4	42.0	27.4	(15.0)	91.2	67.3	35.5

Source: Company data, I-Sec Research

Table 5: Sum-of-the-parts based target price

	Value/share to SBI
SBI (standalone)	1,177
Value of associates	244
Total	1,421
SBI Life Insurance Company	160
Others	78
Value of subsidiaries	239
Target Price	1,660

Source: I-Sec Research

Financial Summary

Table 6: Profit and Loss Statement
(Rs bn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Interest earned	489.5	637.9	806.9	968.0
Interest expended	319.3	429.2	563.0	670.6
Net interest income	170.2	208.7	243.9	297.4
Other income	86.9	126.9	134.5	150.6
Trading gains	9.6	25.6	13.0	11.0
Fee income	59.1	76.2	92.2	106.0
Operating expenses	126.1	156.5	184.4	214.0
Employee costs	77.9	97.5	116.0	134.6
Pre-provisioning profit	131.1	179.2	193.9	234.0
Loan and investment loss provisions	26.7	37.3	49.2	63.1
Profit before tax	104.4	141.8	144.7	171.0
Income taxes	37.1	50.6	48.6	57.4
Net profit	67.3	91.2	96.1	113.5

Source: Company data, I-Sec Research

Table 7: Balance Sheet
(Rs bn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Share Capital	6.31	6.35	6.35	6.35
Reserves and surplus	484.0	573.1	650.0	740.8
Deposits	5,374.0	7,420.7	8,830.7	10,596.8
Borrowings	517.3	537.1	590.9	649.9
Other liabilities and provisions	833.6	1,107.0	1,273.0	1,400.3
Total liabilities & stockholders' equity	7,215.3	9,644.3	11,350.9	13,394.2
Cash and balances with RBI	674.7	1,044.0	887.4	931.8
Investments	1,895.0	2,759.5	3,460.8	4,057.2
Advances	4,167.7	5,425.0	6,564.3	7,942.8
Fixed Assets, net	33.7	38.4	42.2	46.4
Other Assets	444.2	377.3	396.2	416.0
Total assets	7,215.3	9,644.3	11,350.9	13,394.2

Source: Company data, I-Sec Research

Table 8: Key Ratios
(Year ending March 31)

	FY08	FY09	FY10E	FY11E
Per share data (Rs)				
Period end shares outstanding (mn)	631.5	634.9	634.9	634.9
Basic EPS	116.2	144.1	151.4	178.8
Diluted EPS	116.2	144.1	151.4	178.8
Book value per share	776.5	912.7	1,033.8	1,176.9
BV (adjusted for investment in subs.)	716.8	853.4	974.5	1,117.5
Growth ratios (%)				
Total assets	27.4	33.7	17.7	18.0
Advances	23.5	30.2	21.0	21.0
Deposits	23.4	38.1	19.0	20.0
Book value	30.6	17.5	13.3	13.8
EPS	34.7	23.9	5.1	18.1
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	8.3	6.1	5.6	4.7
P/E*	10.7	8.6	8.2	6.9
P/BV*	1.7	1.5	1.3	1.1
P/ABV	2.0	1.7	1.5	1.3
Dividend yield (%)	1.2	1.7	1.8	2.1

Operating ratios (%)

Operating cost to income	49.0	46.6	48.7	47.8
Operating expenses/ Avg. assets	2.0	1.9	1.8	1.7

Profitability ratios (%)

Spread	2.08	1.79	1.53	1.63
NIM (excluding one-offs)	2.81	2.61	2.42	2.49
Return on avg. assets	1.04	1.08	0.92	0.92
Return on avg net worth	16.8	17.1	15.6	16.2

Asset quality and capital (%)

Gross NPA	3.04	2.84	3.15	3.10
Net NPA	1.78	1.76	1.70	1.60
Total CAR	13.47	14.25	13.03	12.51

*P/E & P/BV are arrived at after stripping valuations of subsidiaries and associates from price; investments (at cost) in subsidiaries have been stripped from BV for calculating multiples

Source: Company data, I-Sec Research

Table 9: Quarterly trend
(Rs bn, year ending March 31)

	Sep-08	Dec-08	Mar-09	Jun-09
Net interest income	54.6	57.6	48.4	50.2
% growth (YoY)	45.0	35.3	0.9	4.3
Other income	23.4	32.3	47.2	35.7
Pre-provision profit	41.9	44.8	52.8	36.7
Net profit	22.6	24.8	27.4	23.3
% growth (YoY)	40.2	37.0	45.6	42.0

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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