

# State Bank of India (SBI.BO)

## 2QFY13 Results: Hurting – Only Waiting for the Turn

■ Company Update

<b>Buy</b>	<b>1</b>
Price (09 Nov 12)	Rs2,155.65
Target price	Rs2,625.00
Expected share price return	21.8%
Expected dividend yield	1.6%
<b>Expected total return</b>	<b>23.4%</b>
Market Cap	Rs1,446,539M
	US\$26,608M

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



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- **It's hurting** — A painful quarter: relatively high asset deterioration (5% annualized), surplus liquidity straining on margins (down 23bps qoq) and slackening fee incomes. It's not only the environment – it's a poorly managed quarter too. The headline beat (+30%, 6% ahead of expectations) might suggest things are OK – they are not. The stock should lose some more ground on the market open.
- **Weak asset book, little by way of guidance** — SBI's overall stressed book is now at 10% - weaker than expectations, in line with peers, and poor. While it's a tough environment, we believe SBI's credit selection has also been poor (25% of Mid-Corp loans are stressed). That will keep risks high (and expectations low): with management's guidance fairly muddled, a credit revival now seems primarily contingent on a broader economic revival.
- **It's margins that are the bigger disappointment** — SBI's margins have slipped 23bps over the quarter – in contrast to an up-trending guidance in the last Q. It's explained by the surplus liquidity that SBI has built on its BS: but with management's reluctance to lower deposit pricing – it will only get worse if there isn't a big loan / economic pick up. Bottom line: margins too depend on a loan pick-up (or the slower things go, the worse it could become) – and SBI can only wait.
- **The gains? Only modest ones** — This quarter is almost entirely one-way – down; but there are some gains. There seems to be cushion on capital (+10% Tier estimate for March 13), savings account growth is good (and there are no wholesale deposits), and it is hiring aggressively to enhance distribution. But, it's a small list, that's swamped by a bigger list of troubles.
- **So why still a Buy?** — A tough question – a mix of high Balance-sheet/ margin leverage to an economic uptick, a funding franchise that is in good shape, still decent under-lying profitability (345bps margin) – and the stock's positioning as the 'go to' Government bank if one wants to own one. It's not deeply convincing, but it seldom is when the stock / businesses' chips are down.

**Statistical Abstract**

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2011A	82,645	130.16	-9.8	16.6	2.1	12.6	1.4
2012A	117,073	179.28	37.7	12.0	1.7	15.7	1.6
2013E	124,813	186.00	3.7	11.6	1.5	14.1	1.6
2014E	139,323	207.62	11.6	10.4	1.4	14.0	1.8
2015E	171,603	255.72	23.2	8.4	1.2	15.4	1.9

Source: Powered by dataCentral

**See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.**

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Fiscal year end 31-Mar	2011	2012	2013E	2014E	2015E
<b>Valuation Ratios</b>					
P/E adjusted (x)	16.6	12.0	11.6	10.4	8.4
P/E reported (x)	16.6	12.0	11.6	10.4	8.4
P/BV (x)	2.1	1.7	1.5	1.4	1.2
P/Adjusted BV diluted (x)	2.6	2.1	1.9	1.6	1.2
Dividend yield (%)	1.4	1.6	1.6	1.8	1.9
<b>Per Share Data (Rs)</b>					
EPS adjusted	130.16	179.28	186.00	207.62	255.72
EPS reported	130.16	179.28	186.00	207.62	255.72
BVPS	1,023.40	1,251.05	1,396.28	1,559.63	1,768.75
Tangible BVPS	1,023.40	1,251.05	1,396.28	1,559.63	1,768.75
Adjusted BVPS diluted	828.96	1,015.32	1,147.01	1,369.67	1,725.69
DPS	30.00	35.00	35.00	38.00	40.00
<b>Profit &amp; Loss (Rsm)</b>					
Net interest income	325,264	432,911	456,271	516,357	591,236
Fees and commissions	130,273	135,231	152,668	172,354	192,857
Other operating Income	27,973	8,283	31,621	31,919	33,899
<b>Total operating income</b>	<b>483,510</b>	<b>576,425</b>	<b>640,560</b>	<b>720,630</b>	<b>817,992</b>
Total operating expenses	-230,154	-260,690	-296,055	-331,360	-375,252
<b>Oper. profit bef. provisions</b>	<b>253,356</b>	<b>315,735</b>	<b>344,505</b>	<b>389,270</b>	<b>442,741</b>
Bad debt provisions	-87,921	-125,247	-155,394	-171,830	-175,441
Non-operating/exceptionals	-15,893	-5,656	0	-6,344	-7,295
<b>Pre-tax profit</b>	<b>149,542</b>	<b>184,833</b>	<b>189,111</b>	<b>211,096</b>	<b>260,004</b>
Tax	-66,897	-67,760	-64,298	-71,773	-88,401
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>82,645</b>	<b>117,073</b>	<b>124,813</b>	<b>139,323</b>	<b>171,603</b>
Adjusted earnings	82,645	117,073	124,813	139,323	171,603
<b>Growth Rates (%)</b>					
EPS adjusted	-9.8	37.7	3.7	11.6	23.2
Oper. profit bef. prov.	38.3	24.6	9.1	13.0	13.7
<b>Balance Sheet (Rsm)</b>					
<b>Total assets</b>	<b>12,237,337</b>	<b>13,355,162</b>	<b>15,190,400</b>	<b>17,299,224</b>	<b>19,740,931</b>
Avg interest earning assets	11,036,056	12,429,441	13,967,341	16,059,909	18,460,520
Customer loans	7,730,345	8,953,372	10,499,282	12,287,262	14,341,233
Gross NPLs	253,259	396,761	539,992	646,347	692,152
<b>Liab. &amp; shar. funds</b>	<b>12,237,337</b>	<b>13,355,162</b>	<b>15,190,400</b>	<b>17,299,224</b>	<b>19,740,931</b>
Total customer deposits	9,339,328	10,436,474	11,961,098	13,718,711	15,745,488
Reserve for loan losses	163,151	277,613	418,085	571,599	724,532
Shareholders' equity	<b>649,860</b>	<b>839,512</b>	<b>936,964</b>	<b>1,046,580</b>	<b>1,186,912</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	12.6	15.7	14.1	14.0	15.4
Net interest margin	2.95	3.48	3.27	3.22	3.20
Cost/income ratio	47.6	45.2	46.2	46.0	45.9
Cash cost/average assets	2.0	2.0	2.1	2.0	2.0
NPLs/customer loans	3.3	4.4	5.1	5.3	4.8
Reserve for loan losses/NPLs	64.4	70.0	77.4	88.4	104.7
Bad debt prov./avg. cust. loans	1.2	1.5	1.6	1.5	1.3
Loans/deposit ratio	82.8	85.8	87.8	89.6	91.1
Tier 1 capital ratio	7.8	9.7	9.4	9.1	9.0
Total capital ratio	12.0	14.1	13.5	12.9	12.5

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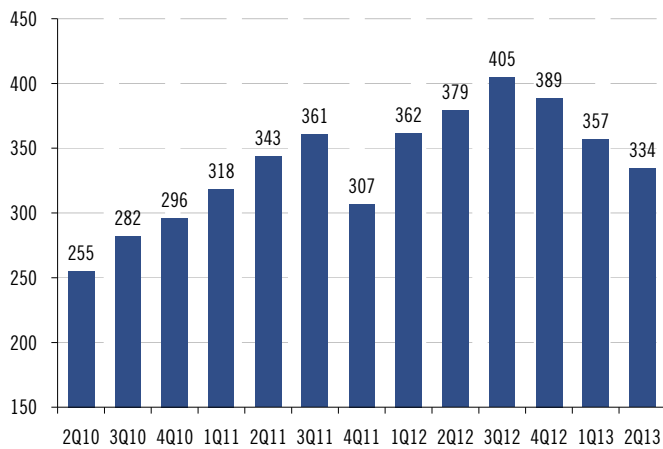


Figure 1. SBI – 2QFY13 Results: Key Financial Highlights (Rupees Million, Percentage)

	2Q13	2Q12	YoY %	1Q13	QoQ%	Citi Research Comments
Interest Income	296,068.5	259,671	14.0	289,167	2.4	
Interest Expense	(186,330)	(155,452)	19.9	(177,979)	4.7	
Net Interest Income	109,738	104,219	5.3	111,188	-1.3	4% below est. and a key disappointment - NIM pressure continues
Fee-Based Income	30,498	33,151	-8.0	32,598	-6.4	14% below our est. and sluggish this quarter - trading fees for franchise, but it could continue to cost
Other Non-Interest Income	2,968	1,121	164.8	2,390	24.2	Trading gains expectedly higher - primary source of earnings upsides for the rest of the year
Non Interest Income	33,466.2	34,272	-2.4	34,988	-4.3	
Operating Income	143,204	138,492	3.4	146,176	-2.0	
Operating Expenses	(69,668)	(63,749)	9.3	(64,410)	8.2	Controlled currently - could rise on impending wage increase, network expansion
Pre-Provision Profit	73,536	74,743	-1.6	81,767	-10.1	
<b>Pre-provisions profit (Ex - trading gains and dividends)</b>	<b>70,569</b>	<b>73,622</b>	<b>-4.1</b>	<b>79,377</b>	<b>-11.1</b>	<b>10% Below our est. - underlies weaker core profitability</b>
Charges for Bad Debts	(20,874)	(30,421)	-31.4	(29,595)	-29.5	Low credit costs (96bps annualized) - unjustified credit pressures, and the primary driver of the earnings beat
Other Operating Items	2,618	(3,434)	NM	5,032	-48.0	
Operating Profit	55,280	40,888	35.2	57,203	-3.4	
Pre-Tax Profit	55,280	40,888	35.2	57,203	-3.4	
Tax	(18,699)	(12,784)	46.3	(19,688)	-5.0	
<b>Net Profit</b>	<b>36,581</b>	<b>28,104</b>	<b>30.2</b>	<b>37,516</b>	<b>-2.5</b>	<b>6% beat BUT diluted by the asset quality deterioration, and an unjustified drop in credit costs</b>
EPS	54.51	44.26	23.2	55.91	-2.5	
Customer Loans	9,269,187	8,106,120	14.3	9,458,190	-2.0	Below estimates - ours and the managements'
Customer Deposits	11,336,439	9,731,711	16.5	11,029,260	2.8	Mix still strong (CASA - 45%) but bank is carrying excess liquidity - could remain a drag
AIEA	12,728,168	10,991,509	15.8	12,462,091	2.1	
AIBL	13,546,542	11,678,053	16.0	13,225,002	2.4	
Total Assets	14,400,611	12,425,169	15.9	14,156,504	1.7	4%qoq growth in RWA - on account of shifting portfolio mix - more SME
Avg Assets	14,278,557	12,453,639	14.7	13,755,848	3.8	
Non-Performing Loans (NPL)	492,025	339,463	44.9	471,864	4.3	Slippages stay elevated (4% annualized) and restructuring incrementally another 2% (annualized)..higher recoveries moderate the balance-sheet deterioration
Loan Loss Reserves (LLR)	(265,879)	(178,258)	49.2	(268,654)	-1.0	Coverage levels have started declining
Shareholders' Funds	920,182	695,271	32.3	877,028	4.9	Tier I at 9.63% including 1H13 profits - good cushion
Book Value Per Share	1,449	1,095	32.3	1,381	4.9	
<b>Key Ratios (%)</b>	<b>2Q13</b>	<b>2Q12</b>	<b>Bps Δ YoY</b>	<b>1Q13</b>	<b>Bps Δ QoQ</b>	
ROAA (annualized)	1.0	0.9	12	1.1	-7	
ROAE (annualized)	15.9	16.2	-27	17.1	-121	
Net Interest Margin (bps)	334	379	-45	357	-23	Surplus balance sheet liquidity a drag on NIMs - disappointing, missing guidance, and unrealistic guidance for the year ahead
Fee Inc/Operating Income	21.3	23.9	-264	22.3	-100	
Other Non-Interest Inc/Op Inc	23.4	24.7	-138	23.9	-57	
Op. Cost/ Operating Income	48.6	46.0	262	44.1	459	
Loan-to-Deposit Ratio (LDR)	81.8	83.3	-153	85.8	-399	
NPL/Loan Ratio	5.3	4.2	112	5.0	32	NPL ratios continue to climb - asset quality outlook remains uncertain, as does management guidance
LLR/NPL Ratio	54	53	153	57	-290	
LLR/NPL (Incl. Technical W/Offs)	62.78	63.50	-72	64.29	-151	Low - and management more focused on earnings than on coverage
Amount of Technical w/o's included	115,568	102,194	13.1	97,193	18.9	
CASA Ratio	44.5	47.6	-312	46.1	-164	Remains high - management continuing to invest and focus on this

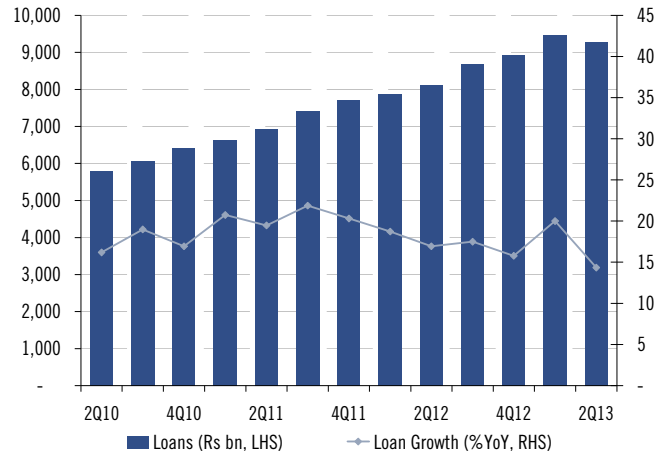
Source: Citi Research

Figure 2. SBI: Net Interest Margins (bps)



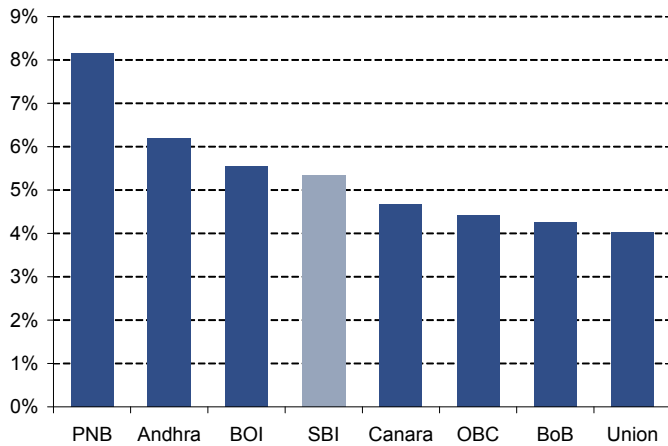
Source: Company Reports

Figure 3. SBI: Loans and Loan Growth (Rupees Billion, %)



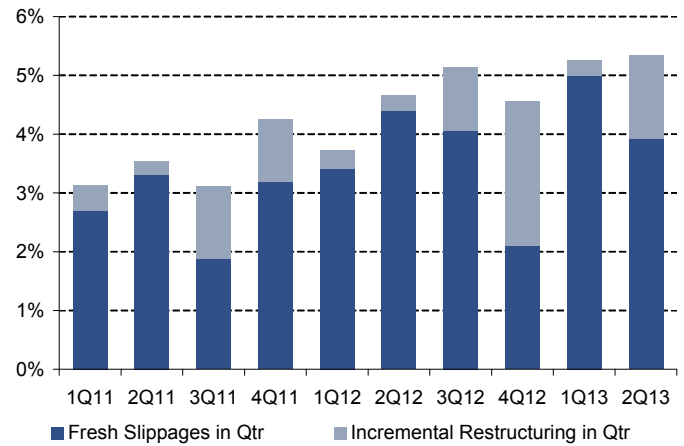
Source: Company Reports

Figure 4. Incremental Stress Across Banks: Slippages + Incremental Restructuring (% Avg. Loans annualized, in 2QFY13)



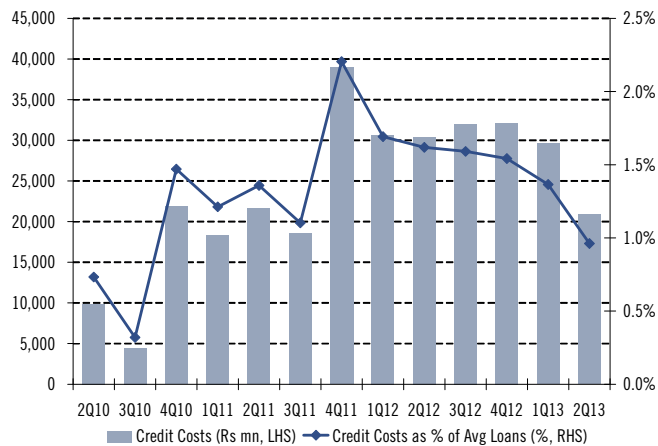
Source: Company Reports

Figure 5. SBI: Incremental Stressed Assets during the Qtr (% Annualized)



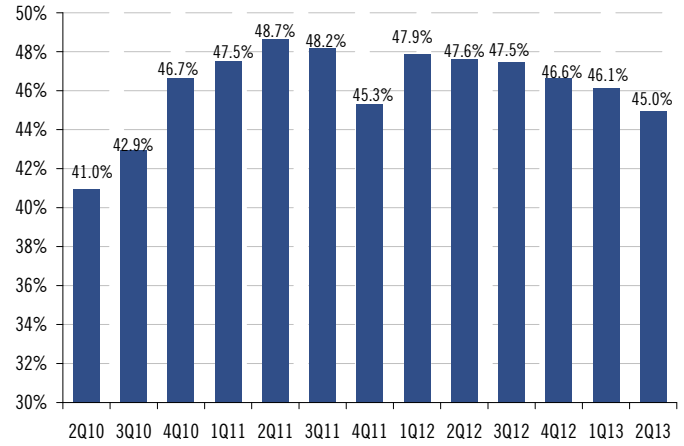
Source: Company Reports

Figure 6. SBI: Credit Costs as % of Average Loans (Rupees Million, %)



Source: Company Reports

Figure 7. SBI: Low Cost Deposit (CASA) Ratio (%)



Source: Company Reports

# State Bank of India

## Company description

SBI is India's largest bank with around 18% market share in deposits and loans, over 13,500 branches and more than 130m customers. Together with its five associate banks (ownership ranging from 75% to 100%), the SBI group has a 25% market share in deposits and loans, and has over 16,000 branches. SBI has the largest overseas presence among Indian banks, with 54 offices in 28 countries. The Government of India owns 61.6% 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 also has a presence in asset management, investment banking and primary dealership. The SBI group has more than 25,000 ATMs, the largest spread in the country, and is aggressively expanding its technology-based offering across its existing network.

## Investment strategy

We rate SBI shares as Buy. SBI has faced significant pain recently in terms of operational, accounting and execution slippages. However, we believe its strong deposit franchise, strong market positioning, well diversified asset book and large distribution network are key strengths, which position it well in a rising interest rate and tight liquidity environment. While there are challenges on execution, the new management does seem to be focused on making operational improvements. We believe the SBI should be able to stabilize its key operating parameters namely net interest margins, operating costs and asset quality slippages – after dipping most recent. Also, a likely healthy economic and growth environment will also improve its own growth and return profile going ahead. We see value in the stock at current levels.

## Valuation

Our target price of Rs2,625 is based on our EVA model, in which we assume a risk-free rate of 8%, in line with the market level. Our longer-term loan loss assumption is 100bps pa (in line with the industry). Our target price for SBI includes a subsidiary valuation of Rs463: Life Insurance at Rs68 per share, associate banks at 1.25x 1Yr Fwd PBV (Rs464), value for SBI's Asset management business (Rs28, 5% of assets) and incorporates capital markets subsidiary at Rs48 based on 10x 1Yr Fwd PE. We also use a sum of parts valuation which values SBI at Rs2,601 per share. In this valuation, we benchmark the consolidated banking business off a 1.3x 1Yr Fwd P/BV – slight premium to our benchmark valuation for its peers. We also add Rs144 per share for its non-banking subsidiary businesses as detailed earlier. We base our target price on EVA, as we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business

## Risks

Downside risks that could impede the stock from reaching our target price include: (1) A sharp rise in interest rates; (2) Asset quality concerns continuing - given strong loan growth and a weak macro-economic environment high; (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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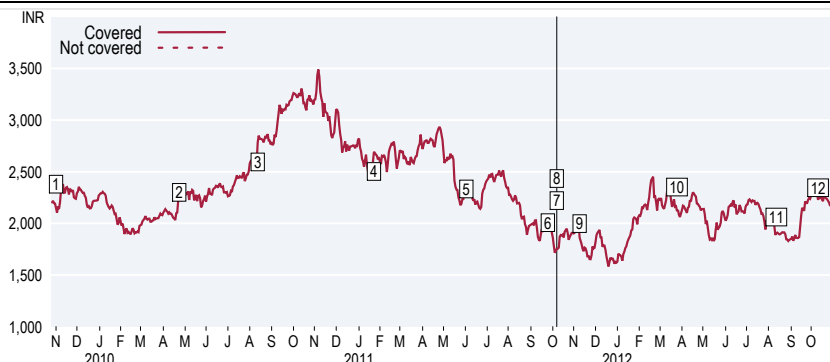
### IMPORTANT DISCLOSURES

#### State Bank of India (SBI.BO)

##### Ratings and Target Price History

##### Fundamental Research

Analyst: Aditya Narain, CFA  
Covered since March 26 2012



	Date	Rating	Target Price	Closing Price
1	2-Nov-09	1L	*2,495.00	2,191.00
2	23-Apr-10	1L	*2,515.00	2,255.60
3	12-Aug-10	1L	*3,235.00	2,784.00
4	23-Jan-11	1L	*3,110.00	2,597.95

	Date	Rating	Target Price	Closing Price
5	2-Jun-11	1L	*2,650.00	2,332.95
6	26-Sep-11	1L	*2,500.00	1,951.20
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	2,500.00	1,751.85

	Date	Rating	Target Price	Closing Price
9	9-Nov-11	1	*2,250.00	1,862.50
10	26-Mar-12	1	*2,500.00	2,118.30
11	12-Aug-12	1	*2,200.00	1,887.95
12	10-Oct-12	1	*2,625.00	2,227.20

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

#### State Bank of India (SBI.BO)

##### Ratings and Target Price History

##### Best Ideas Research

##### Relative Call (3 Month)

Analyst: Aditya Narain, CFA  
Covered since March 26 2012



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	2,584.65

	Date	Rating	Target Price	Closing Price
2	9-Apr-12	*REM MP	-	2,101.30

	Date	Rating	Target Price	Closing Price
3	30-Jun-12	*N	-	2,159.15

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 4 Oct 2012	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Research Global Fundamental Coverage	51%	38%	11%	7%	85%	7%
% of companies in each rating category that are investment banking clients	50%	47%	45%	59%	47%	50%

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