



State Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,966	SBIN IN
	REUTERS CODE
S&P CNX: 4,134	SBI.BO

14 May 2007

Buy

Previous Recommendation: Buy

Rs1,206

Equity Shares (m)	526.3
52-Week Range	1,379/684
1,6,12 Rel.Perf.(%)	17/3/12
M.Cap. (Rs b)	634.6
M.Cap. (US\$ b)	15.5

YEAR	NET INCOME	PAT	EPS	CONS.	P/E	P/BV	CONS.	CAR	ROE	ROA
END	(RS M)	(RS M)	(RS)	EPS (RS)	(X)	(X)	P/BV (X)	(%)	(%)	(%)
3/07A	218,235	45,413	86.3	120.9	10.0	2.0	1.5	12.3	15.4	0.8
3/08E	244,433	52,957	100.6	137.2	8.8	1.8	1.3	10.9	15.8	0.8
3/09E	285,506	62,524	118.8	160.4	7.5	1.6	1.1	10.2	16.4	0.8

SBI reported 22% NII growth in 4QFY07 to Rs43.2b v/s our estimate of 15% growth, as margins improved QoQ as well as YoY. PAT at Rs14.9b was much higher than our estimate (Rs10.4b), mainly on account of Rs9.5b write-back of provisions in 4QFY07. Deposits grew 15% YoY while advances increased by 29% to Rs3.37t. Asset quality has been a concerning factor - net NPLs have increased by 11bp QoQ despite higher NPA provisions.

- ✍ Balance sheet growth picks up - deposit growth of 15%, loan growth of 29%
- ✍ Margins expand YoY as well as QoQ
- ✍ NII growth at 22% YoY in 4QFY07, better than expected
- ✍ Fee income - progression continues to be strong
- ✍ Operating expenses under control

With a stronger outlook on margins and fee income coupled with stable costs, operating profit growth should remain robust. We are building in higher provisions on account of higher delinquencies, going forward. SBI Life Insurance has witnessed strong growth in FY07 and we value SBI Life at Rs150 per share of SBI. We are raising our target price to Rs1,400 to account for the strong operating environment, the value of its life insurance venture and AS-15 losses.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4QA	1Q	2Q	3Q	4Q		
Interest Income	91,663	85,614	95,582	85,091	88,362	93,775	97,359	115,415	359,796	394,910
Interest Expenses	49,131	49,535	53,383	49,545	49,521	54,788	57,846	72,213	203,904	234,368
Net Interest Income	42,532	36,079	42,199	35,546	38,841	38,987	39,513	43,201	155,891	160,542
% Change (Y-o-Y)	44.0	6.8	15.3	-10.0	-8.7	8.1	-6.4	21.5	11.8	3.0
NII, adjusted for one-off items	35,412	36,079	29,669	35,546	38,841	38,987	39,513	43,201	136,706	160,542
Other Income	15,766	12,946	18,404	23,616	17,626	14,338	18,110	28,941	43,850	57,693
Net Income	58,298	49,026	60,603	59,162	56,467	53,324	57,623	72,142	199,741	218,235
% Change (Y-o-Y)	29.8	-2.6	2.8	4.9	-3.1	8.8	-4.9	21.9	-5.2	9.3
Operating Expenses	23,903	29,197	34,607	29,544	28,101	28,599	29,074	32,460	117,251	118,235
Operating Profit	34,395	19,829	25,996	29,618	28,366	24,726	28,549	39,682	82,490	99,999
% Change (Y-o-Y)	66.0	-23.9	-23.3	1.3	-17.5	24.7	9.8	34.0	-24.9	21.2
Other Provisions	17,666	8,175	4,698	10,237	12,820	6,813	11,662	14,126	13,428	24,096
Provision for Taxes	4,501	-500	10,147	10,847	7,559	6,067	6,237	10,626	24,995	30,490
Net Profit	12,228	12,154	11,151	8,533	7,987	11,845	10,650	14,930	44,067	45,413
% Change (Y-o-Y)	15.5	12.3	1.4	-19.9	-34.7	-2.5	-4.5	75.0	2.4	3.1
Cost to Income Ratio	41.0	59.6	57.1	49.9	49.8	53.6	50.5	45.0	58.7	54.2
Interest Exp / Interest Earned	53.6	57.9	55.9	58.2	56.0	58.4	59.4	62.6	56.7	59.3
Other Income / Net Income	27.0	26.4	30.4	39.9	31.2	26.9	31.4	40.1	22.0	26.4

SBI reported 22% NII growth in 4QFY07 to Rs43.2b v/s our estimate of 15% growth, as margins improved QoQ as well as YoY. PAT at Rs14.9b was much higher than our estimate (Rs10.4b), mainly on account of Rs9.5b write-back of provisions in 4QFY07. Deposits grew 15% YoY while advances increased by 29% to Rs3.37t. Asset quality has been a concerning factor - net NPLs have increased by 11bp QoQ despite higher NPA provisions.

Balance sheet growth picks up - deposit growth of 15%, loan growth of 29%

Over the last couple of quarters, balance sheet growth has been picking up for SBI. Deposits increased by 15% YoY (11% YoY in 3QFY07) to Rs4.35t (QoQ increase of 7.7%) while net advances increased by 29% YoY to Rs3.37t. C-D ratio has increased to 77% from 69%, a year ago.

Retail advances growth slowed down to 21% in line with the bank's strategy to restrict loan growth, especially in mortgages. The proportion of retail loans decreased to 21.5% from 23.3% in FY06. Mortgages grew by 19.6% in FY07 (51% of retail credit).

CASA ratio was maintained at 43.6% in FY07. The management reiterated its strategy of gaining market share in FY08 although it aims to increase its advances by 25% and deposits by 21%. It targets an increase in CASA ratio by 300bp in FY08, driven by rural business and retail deposits. Even in FY07, 60% of SBI's incremental deposits came from the retail segment v/s 45% in FY06. With technology in place, SBI would now get very aggressive in salary accounts, broker accounts, and government business, increasing the proportion of CASA deposits.

Margins expand YoY as well as QoQ

Overall, NIMs have increased to 3.3% in FY07 v/s 2.9% in FY06 (3.29% in 9MFY07). In 4QFY07, margins were marginally higher at 3.34%.

This was a result of an increase in the yield on advances by 89bp YoY to 8.67%. Cost of deposits increased by ~30bp to 4.79% for FY07. Yield on investments decreased to

6.88% in FY07 from 7.10% in FY06 while it remained stable QoQ.

We expect margins to remain stable in 1QFY08. However, as deposit costs start rising faster from 2QFY08 onwards, we expect some moderation in margins. Overall, we expect margins to be down 12bp in FY08.

YIELDS COSTS AND MARGINS (%)

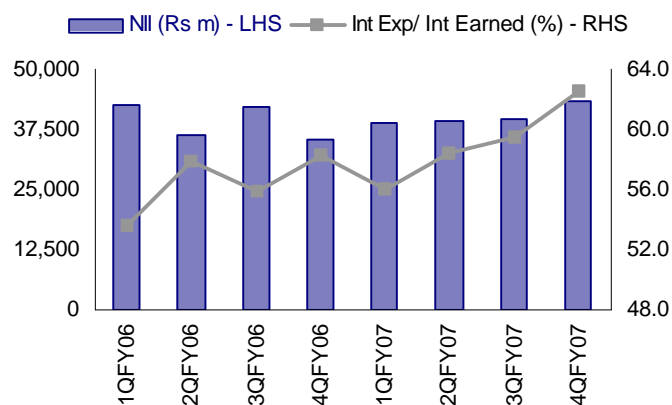
	FY06	1HFY07	9MFY07	FY07
Avg Yield on Advances	7.78	8.55	8.61	8.67
Avg Yield on Investments	7.10	6.94	6.87	6.88
Avg Cost of Deposits	4.49	4.51	4.57	4.79
NIMs	2.92	3.32	3.29	3.32

Source: Company/Motilal Oswal Securities

NII growth at 22% YoY in 4QFY07, better than expected

SBI reported 22% NII growth in 4QFY07 to Rs43.2b v/s our estimate of 15% growth. This was mainly as margins were better in 4QFY07 at 3.34% as compared to 3.29% in 9MFY07.

NII TREND



Source: Company/Motilal Oswal Securities

As required by the auditors, the bank has reclassified the way it books interest income on FCNR deposits. It has now started booking interest on FCNR deposits as part of interest income and interest expenses as compared to only reporting the spread as interest income earlier. This has resulted in a sharp increase in interest on RBI balances to Rs16.3b v/s Rs3.5b in 4QFY06. Interest expenses have also increased by 25% QoQ. However, there is no effect on NII.

Fee income - progression continues to be strong

Core fee income increased by 21% YoY in 4QFY07. Even in FY07, core fee income increased by 20%. Management has reiterated that there has been increased focus on fee income and the growth is coming from all fee-generating avenues. With CBS now capturing more than 70% of the business (90% for the SBI group), leakages from the system have reduced. Also, the bank is now charging processing fees for all loans; these were usually waived off, earlier. Also, on the retail front, the bank has become very aggressive on third-party products and insurance distribution. Overall fee income is likely to witness strong growth over the next couple of fiscals.

Amortization write-back results in higher other income

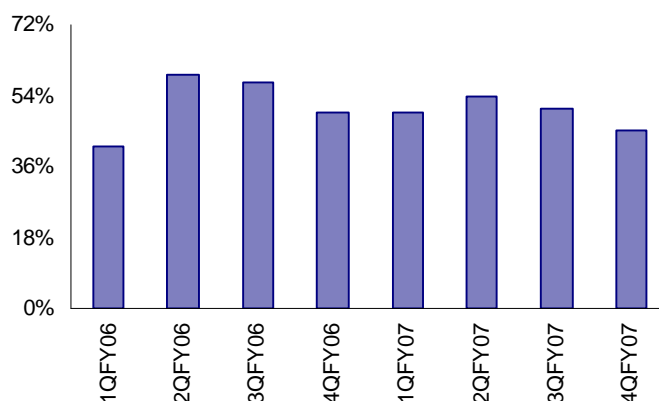
The bank reversed excess amortization on HTM investments to the extent of Rs9.5b during 4QFY07. This resulted in a negative amortization expense of Rs4.5b in 4QFY07 v/s a positive expense of Rs3.2b in 4QFY06. This write-back helped the other income to grow by 23% YoY, despite lower treasury and forex profits (down respectively by 52% and 44% YoY) as well as reduced miscellaneous income (fell 97% YoY to Rs152m).

Operating expenses under control

SBI continued to exercise strict control on operating costs - total opex remained flat in FY07. Employee cost reduced 2% to Rs79b. During 4QY07, total opex increased 10% YoY and 11% QoQ mainly on account of increase in non-staff expenditure by 19% YoY and 39% QoQ. Resultantly, cost-to-income ratio reduced from 58.7% in FY06 to 54.2% in FY07. In 4QFY07, it dropped to 45% from ~50% in 3QFY07 and 4QFY06. The bank attributed this fall in staff cost to natural attrition of about 6,000 employees during the year. The management guided similar number of exits during each of the next 3-4 years, while it also plans to add more than 6,000 employees per year during the same period.

The management reiterated their AS-15 shortfall of ~Rs45b, which would be adjusted against reserves over the next five years. The final guidelines are yet to be notified.

COST TO INCOME RATIO



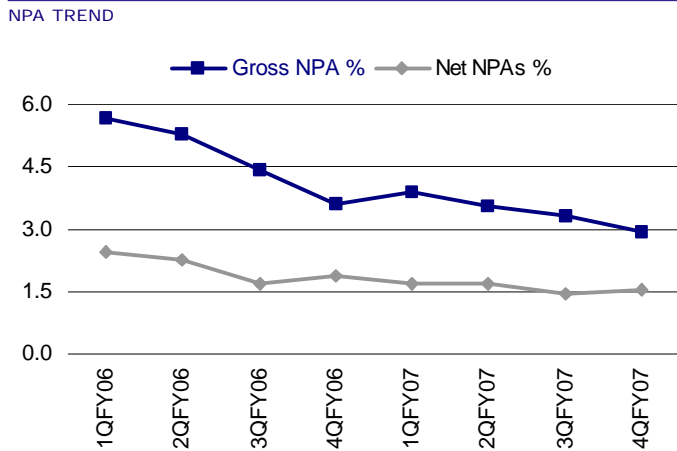
Source: Company/Motilal Oswal Securities

Provisions higher YoY

Provisions were higher YoY on account of higher NPA provisions (Rs14.37b in FY07 v/s Rs1.5b in FY06), and higher standard asset provisions (Rs5.8b in FY07 v/s Rs4.1b in FY06). The bank had used floating provisions of Rs8.4b during FY06 to lower overall NPA provisions charge in profit and loss account. Tax rates remained high, increasing to 40% in FY07 (42% in 4QFY07, 37% in 3QFY07). However, Rs2.6b of one-off accounting adjustment also contributed to increase in the tax provision during 4QFY07.

Asset quality trends have been concerning

SBI has restated the NPA numbers for FY06 as well as 3QFY07. Based on the revised numbers, gross NPAs increased by 4% YoY and remained flat QoQ. Net NPAs increased 7% YoY and 17% QoQ. Gross NPA ratio reduced to 2.92% from 3.61% (revised number) in FY06 and 3.15% in 3QFY07. Net NPA ratio decreased to 1.56% from 1.88% a year ago while it increased QoQ by 11bp. Provision coverage decreased to 47% from 49% a year ago and 55% in 3QFY07.



Source: Company/Motilal Oswal Securities

Increase in delinquency in 4QFY07 and going ahead is a concerning factor. The key areas where delinquencies could increase are SMEs, retail and agriculture. We are increasing our NPA provisioning from 55bp (12 month lagged) to 80bp in FY08 and 90bp in FY09. The management, however, is hopeful of continued strong recoveries.

Tier-I capital of 8%; capital raising in FY08

Currently, SBI has a total capital adequacy of 12.3% - increase of 48bp QoQ in CAR. Tier-I remained flat QoQ

at 8% while it decreased by 135bp YoY. Management guided Rs150b of capital (debt +equity) raising during FY08; however, the composition of the same is yet to be firmed up. Owing to the new BASEL II guidelines, SBI could lose about 100bp of capital. We expect SBI to come up with its follow-on offering in 2HFY07 to shore up core Tier-I funds, considering the bank's aggressive asset expansion plans. However, according to current guidelines, the government holding cannot decline below 55%. Thus, the total dilution would be capped at ~9% of the current capital.

Valuation and view

Given the stronger outlook on margins and fee income, coupled with stable costs, SBI's operating profit growth should remain robust. We are building in higher provisions on account of higher delinquencies, going forward. SBI Life Insurance has witnessed strong growth in FY07 and we value SBI Life at Rs150 per share of SBI. Accounting for the strong operating environment, the value of its life insurance venture and AS-15 losses, we are raising our target price to Rs1,400 (1.2x FY09E Consolidated BV plus Rs150/share value of insurance subsidiary minus Rs60/share of AS-15 losses).

State Bank of India: an investment profile

Company description

State Bank of India (SBI) is the largest commercial bank in India, with a balance sheet size of over Rs5t. The bank, along with associate banks, has a network of over 14,000 branches across India and controls over 18% of the banking business. The government owns 57% of the bank, with FIIs owning 20% (maximum permissible is 20%). Over the last couple of years, SBI has been focusing on drawing significant synergies through an internal consolidation of its associate banks.

Key investment arguments

- ✍ Proxy to Indian economy; will benefit from up-tick in loan growth.
- ✍ Significant re-pricing of funds will result in stable margins.
- ✍ Associate banks have been performing well and add significant value.
- ✍ Natural attrition will pull down operating costs significantly over the next 3-4 years.

Key investment risks

- ✍ Significant rise in interest rates; the bank currently has ~30% of its investment book in AFS.
- ✍ Delay in technology upgradation could result in loss of market share.

COMPARATIVE VALUATIONS

		SBI	PNB	BOI
P/E (x)	FY08E	8.8	7.7	7.3
	FY09E	7.5	6.2	6.0
P/BV (x)	FY08E	1.3	1.4	1.5
	FY09E	1.1	1.2	1.2
RoE (%)	FY08E	15.8	19.0	20.9
	FY09E	16.4	20.0	21.4
RoA (%)	FY08E	0.8	1.2	0.9
	FY09E	0.8	1.3	0.9

SBI P/E and P/BV are on consolidated basis

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	60.9	60.6	59.7
Domestic Inst	11.0	11.9	11.6
Foreign	19.8	19.8	19.8
Others	8.3	7.7	8.9

Recent developments

- ✍ SBI has been raising capital in the form of upper tier-2 capital (raised Rs69b in 9MFY07).
- ✍ SBI has appointed Infosys to network its overseas branches and TCS is networking the domestic branch network.

Valuation and view

- ✍ We expect loan growth, stable margins to drive earnings growth over the next few quarters. Cost efficiency and NPA recovery will be the next big triggers for earnings growth.
- ✍ The stock trades 7.5x FY09E consolidated EPS and 1.1x FY09E consolidated BV. Maintain **Buy**.

Sector view

- ✍ YTD loan growth of 28%.
- ✍ Volatility in interest rates will impact bond gains.
- ✍ Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- ✍ We maintain an overweight stance on the sector.

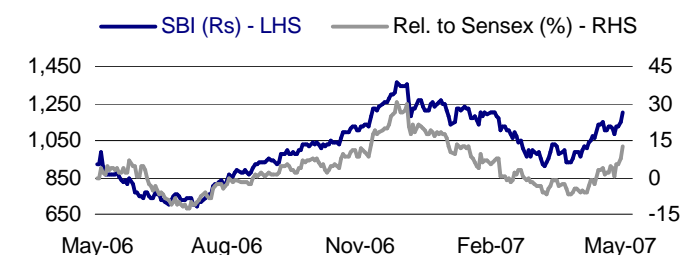
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	100.6	105.0	-4.2
FY09	118.8	119.5	-0.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,206	1,400	16.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2006	2007E	2008E	2009E	
Interest Income	359,796	394,910	480,141	579,584	
Interest Expended	203,904	234,368	295,656	364,128	
Net Interest Income	155,891	160,542	184,485	215,456	
Change (%)	11.8	3.0	14.9	16.8	
Other Income	43,850	57,693	59,947	70,050	
Profit on sale of investment	5,872	5,678	5,000	5,000	
Other non-interest income	37,978	52,015	54,947	65,050	
Net Income	199,741	218,235	244,433	285,506	
Change (%)	-5.2	9.3	12.0	16.8	
Operating Expenses	117,251	118,235	131,405	146,036	
Employee expense	81,230	79,326	85,232	93,468	
Operating Income	82,490	99,999	113,028	139,470	
Change (%)	-24.9	21.2	13.0	23.4	
Provisions & contingencies	13,428	24,096	33,987	46,150	
Provision for NPAs	1,478	14,295	26,987	37,950	
PBT	69,062	75,903	79,041	93,319	
Tax	24,995	30,490	26,083	30,795	
PAT	44,067	45,413	52,957	62,524	
Change (%)	2.4	3.1	16.6	18.1	
Proposed Dividend	8,402	7,368	8,947	10,526	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2006	2007E	2008E	2009E	
Capital	5,263	5,263	5,263	5,263	
Reserves & Surplus	271,178	307,970	350,459	400,668	
Net Worth	276,441	313,233	355,722	405,931	
Deposits	3,800,461	4,355,210	5,269,804	6,060,275	
Change (%)	3.5	14.6	21.0	15.0	
Borrowings	306,412	398,336	458,087	526,800	
Other Liabilities & Prov.	555,384	694,228	867,785	1,084,731	
Total Liabilities	4,938,696	5,761,007	6,951,397	8,077,735	
Current Assets	445,600	486,109	561,065	659,753	
Investments	1,625,342	1,625,342	1,869,144	2,149,515	
Change (%)	-17.5	0.0	15.0	15.0	
Advances	2,616,415	3,373,360	4,216,700	4,933,539	
Change (%)	29.3	28.9	25.0	17.0	
Net Fixed Assets	27,529	30,005	33,680	37,039	
Other Assets	223,808	246,189	270,808	297,889	
Total Assets	4,938,696	5,761,007	6,951,397	8,077,735	

ASSUMPTIONS	(%)			
Deposit Growth	3.5	14.6	21.0	15.0
Advances Growth	29.3	28.9	25.0	17.0
Investments Growth	-17.5	0.0	15.0	15.0
Dividend	140.0	140.0	170.0	200.0

E: M O S t Estimates

RATIOS		2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets		8.0	7.8	8.0	8.1
Avg. Cost-Int. Bear. Liab.		5.1	5.3	5.6	5.9
Interest Spread		2.8	2.5	2.3	2.2
Net Interest Margin		3.4	3.2	3.1	3.0

Profitability Ratios (%)		2006	2007E	2008E	2009E
RoE		17.0	15.4	15.8	16.4
RoA		0.9	0.8	0.8	0.8
Int. Expended/Int. Earned		56.7	59.3	61.6	62.8
Other Inc./Net Income		22.0	26.4	24.5	24.5

Efficiency Ratios (%)		2006	2007E	2008E	2009E
Op. Exps./Net Income		58.7	54.2	53.8	51.1
Empl. Cost/Op. Exps.		69.3	67.1	64.9	64.0
Busi. per Empl. (Rs m)		30.5	36.7	44.2	52.0
NP per Empl. (Rs lac)		2.2	2.4	2.7	3.2

Asset-Liability Profile (%)		2006	2007E	2008E	2009E
Adv./Deposit Ratio		68.8	77.5	80.0	81.4
Invest./Deposit Ratio		42.8	37.3	35.5	35.5
G-Sec/Invest. Ratio		85.0	93.5	87.8	82.5
Gross NPAs to Adv.		3.6	2.9	2.5	2.5
Net NPAs to Adv.		1.8	1.6	1.4	1.4
CAR		11.9	12.3	10.9	10.2
Tier 1		9.4	8.0	6.8	6.5

VALUATION		2006	2007E	2008E	2009E
Book Value (Rs)		525.3	595.2	675.9	771.3
Price-BV (x)		2.3	2.0	1.8	1.6
Adjusted BV (Rs)		466.9	530.2	600.8	682.7
Price-ABV (x)		2.6	2.3	2.0	1.8
EPS (Rs)		83.7	86.3	100.6	118.8
EPS Growth (%)		2.4	3.1	16.6	18.1
Price-Earnings (x)		14.4	14.0	12.0	10.1
OPS (Rs)		156.7	190.0	214.8	265.0
OPS Growth (%)		-24.9	21.2	13.0	23.4
Price-OP (x)		7.7	6.3	5.6	4.5

E: M O S t Estimates

N O T E S



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State Bank of India

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|---|-----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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