

State Bank of India

Rs1206
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs635bn; US\$15.3bn

Analyst: Pathik Gandotra (91-22-6638 3304; pathik@sski.co.in)
Veekesh Gandhi (91-22-6638 3231; veekesh@sski.co.in)
Nilesh Parikh, CFA (91-22-6638 3325; Nilesh@sski.co.in)

Result: Q4FY07

Comment: Strong operating performance; Earnings upgrade by 4.8% and 1.6% for FY08 and FY09, respectively

Last report: 23 January 2007 (Price Rs1169; Recommendation: Outperformer)

Key valuation metrics

Year to 31 March	2004	2005	2006	2007E	2008E	2009E
Net profit (Rs mn)	36,810	43,045	44,067	45,432	52,691	62,094
yoy growth (%)	18.6	16.9	2.4	3.1	16.0	17.8
Shares in issue (mn)	526.3	526.3	526.3	526.3	526.3	526.3
EPS (Rs)	69.9	81.8	83.7	86.3	100.1	118.0
EPS growth (%)	18.6	16.9	2.4	3.1	16.0	17.8
PE (x)	17.2	14.7	14.4	14.0	12.0	10.2
Book value (Rs/share)	384	457	525	594	674	769
Consolidated Book value (Rs/share)	486	591	666	762	902	1038
P/ Consolidated Book (x)	2.4	1.9	1.7	1.5	1.3	1.1
RONW (%)	19.7	19.4	17.0	15.4	15.8	16.4

SBI reported 22% NII growth in Q4FY07 to Rs43.2bn vs. estimated 15% growth. PAT at Rs14.9bn was much higher than our expectations (Rs11.9bn) mainly on account of provisions write back of Rs9.5bn in Q4FY07. Overall margins have remained stable from 9MFY07. Due to a reversal of Rs9.5bn of excess amortization charges made during previous years, other income of the bank grew by 23% yoy in Q4FY07; core fee income also grew by a healthy 25%. SBI's loan and deposits grew robust with loans growing by 29% and deposits growing by 15%. SBI's pricing power is evident in the way it has been able to increase loan yields, contain costs with high CASA ratio and improve pricing on non-fund based businesses. SBI has demonstrated the benefits of size by showing the strong operating performance characterized by strong core income growth. On back of strong Q4FY07 operating performance, we have upgraded our earnings numbers by 4.8% and 1.6% for FY08 and FY09, respectively. We expect the bank to deliver a CAGR of 16.9% in earnings over FY07-09E (pre-dilution), with RoE going up to 16.4% by FY09. The stock trades at 1.3x FY08E and 1.1x FY09E consolidated book. Reiterate Outperformer.

KEY HIGHLIGHTS

□ Operating performance better than expectation

SBI has reported 21.5% yoy growth in NII* for Q4FY07, which is better than our estimate of 14%. Moderate growth in deposits led by focus on low cost deposits coupled with better growth in advances (29% yoy) and improving NIMs have contributed to higher growth in NII.

** 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 vs. Rs3.5b in Q4FY06. As a result, interest expenses have also increased by 25% qoq. However, there is no effect on NII. Earlier quarter numbers are also restated.*

Break-up of advances

Rs. In BN	Outstanding Mar-07	% of total advances	YoY growth %
Retail Assets	736	22	21
of which Housing Advances	380	11	19
Agri advances	350	10	33
Mid Corporates	875	26	38
Others	1412	42	79
Total Advances	3,373	100	29

Source: company

□ Stable margins

Overall NIMs have increased to 3.3% in FY07 compared to 2.9% (hit by various one-timers) in FY06 although are stable from 9MFY07. SBI has been raising its PLR (FY06 by 125bps), which has resulted in loan yields rising by 89bps in FY07. Simultaneously, ability to maintain CASA at 43% and keep its share of bulk deposits low it has also been able to contain its costs (an increase of 30bps since March 2006).

SBI has increased its deposit (card) rates in the month of Jan-2007 and surge in bulk deposit rates in latter half of Q4FY07 would result in deposit costs moving up only in 2HFY08. On the other hand SBI has increased its BPLRs by 125bps since Feb-April 2007, which will re-price in 1HFY08. As a result we expect margins for SBI to remain nearly stable to improve in 1HFY08 and plateau in 2HFY08, as deposit re-pricing kicks in.

Yield, cost and spread analysis

For the quarter ended (%)	Mar-06	Dec-06	Mar-07
Yield on Advances	7.46	8.66	8.73
Yield on Advances (reported)	7.78	8.61	8.67
Yield on investments	8.08	7.76	7.85
Yield on investments (reported)	7.10	6.87	6.88
Yield on Advances & Investments - (a)	7.70	8.36	8.46
Cost of Deposits - (b)	4.51	4.71	5.43
Cost of Deposits (reported)	4.77	4.57	4.79
Deposit spread (a - b)	3.19	3.65	3.03
NIM	2.87	2.89	2.98
NIM (reported)	2.92	3.29	3.31

Source: SSKI Research & Company, Reported ratios are on cumulative basis i.e. for March they are for 12 months, As SBI does not declare total assets on quarterly basis, we use declared RoA for the quarter to determine average assets during the quarter and NIM is calculated accordingly.

□ Healthy performance on core fee income front

On the core fee income, the bank recorded a 28% yoy growth (Rs 23.9bn in Q4FY07 vs. Rs18.6bn in Q4FY06), while on treasury front, the bank earned profits of Rs382m in Q4FY07 compared to Rs800m in Q4FY06. Even in FY07, fee income increased by 20% yoy to Rs48bn while treasury profits remained flat yoy. During Q4FY07, SBI reversed Rs9.5bn of excess amortization charges made in earlier years, which enabled the total other income to grow by 23% yoy in Q4FY07.

We expect strong focus on fee income going forward. In addition to its existing thrust on fund based fee income, government business and sale of third-party products the bank will soon venture through various JVs and subsidiary routes in to venture capital, private equity, wealth management, infrastructure fund, pension fund management and general insurance businesses to boost its other income streams.

❑ Trend in expenses containment maintained

During Q4Y07, total operating expenses increased 10% yoy and 11% qoq mainly on account of increase in non-staff expenditure by 19% yoy and 39% qoq. Cost to income ratio fell in Q4FY07 to 44% from ~50% in Q3FY07 as well as Q4FY06. Bank attributed this fall in staff cost to natural attrition and special exit schemes which resulted in some 6000 employees leaving during the year. Management expects similar number of exits during each of the next 3-4 years, while it plans to add over 6000+ employees in specialist categories like IT, agriculture, wealth management, etc.

Bank continued to exercise strict control on the operating costs as total operating expenses remained flat yoy in FY07 while employee cost fell 2% yoy to Rs79bn. For the year cost to income ratio declined by 450bps to 54.2% yoy in FY07.

❑ Provisions remain high on account of mark-to market losses and higher standard asset provisioning

SBI's total provisions of Rs14.1bn for the quarter are largely in line with our estimates. NPA related provisions were substantially low in FY06 compared to FY07 (Rs1.48bn compared to Rs14.3bn in FY07) due to Dabhol becoming a standard asset and Rs8.5bn of floating provisions utilization. Overall, higher standard asset provisions of Rs3.0bn due to RBI requirement and mark-to-market losses due to movement in yields have marked Q4FY07.

Break-up of provisions

Break-up of provisions	Amount (Rs bn)
NPA related	7.3
Investment depreciation	3.3
Standard assets related provisions	3.0
Others	0.6
Total	14.1

Source: company

❑ Asset quality comfortable

SBI has restated the NPA numbers for FY06 as well as Q3FY07. In terms of NPAs, the bank has netted of Rs9bn of suspense accounts from gross NPAs and provisions, which has resulted in lower gross NPAs and lower provisions though net NPAs are unchanged. 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 Q3FY07. Net NPA ratio decreased to 1.56% from 1.88% a year ago while it increased qoq by 11bps. Provision coverage decreased to 47% from 49% (revised) a year ago.

❑ Will need capital in 2HFY08 to adhere to new CAR guidelines

CAR is at 12.3% while Tier 1 is 8.0%. SBI will be requiring Rs150b of capital (debt + equity) during 2HFY08 though no details are firmed up yet. The bank would lose about 90bps of capital Adequacy due to the new CAR guidelines. We expect capital raising in latter half of FY2008.

❑ Maintain Outperformer

SBI has demonstrated the benefits of size by showing the strong operating performance characterized by strong core income growth. On back of strong Q4FY07 operating performance, we have upgraded our earnings numbers by 4.8% and 1.6% for FY08 and FY09, respectively. We expect the bank to deliver a CAGR of 16.9% in earnings over FY07-09E (pre-dilution), with RoE going up to 16.4% by FY09. The stock trades at 1.3x FY08E and 1.1x FY09E consolidated book. Reiterate Outperformer.

Quarterly results

	Q4FY06	FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07E	FY08E
Total intt income	85,091	359,796	88,361	93,775	97,359	115,415	394,910	443,130
Interest expense	49,545	203,904	49,521	54,788	57,846	72,213	234,368	265,912
Net interest income	35,546	155,891	38,841	38,987	39,513	43,201	160,542	177,217
yoy growth (%)	(0.6)	10.7	9.7	8.1	21.0	21.5	15.1	10.4
Other income	23,616	43,849	17,626	14,338	18,110	28,943	57,692	64,526
yoy growth (%)	39.7	(37.2)	11.8	10.7	38.4	22.6	31.6	11.8
Non trading income	22,816	37,978	15,513	14,261	15,004	28,561	52,015	60,026
yoy growth (%)	54.1	(27.0)	7.3	36.1	27.2	25.2	37.0	15.4
Trading	800	5,872	2,113	77	3,106	382	5,678	4,500
Net revenue	59,161	199,741	56,467	53,324	57,624	72,144	218,234	241,743
Operating expenses	29,544	117,251	28,102	28,598	29,074	32,460	118,235	126,537
Operating profit	29,617	82,490	28,364	24,726	28,550	39,684	99,999	115,206
yoy growth (%)	16.2	(24.9)	4.0	24.7	156.2	34.0	51.3	15.2
Total provisions	13,392	13,428	12,820	6,813	11,662	14,126	24,077	30,221
PBT	16,226	69,061	15,545	17,912	16,888	25,558	75,922	84,986
Tax	10,847	24,995	7,559	6,067	6,237	10,626	30,490	32,295
PAT	8,533	44,067	7,986	11,845	10,650	14,932	45,432	52,691
yoy growth (%)	(19.9)	2.4	(34.7)	(2.5)	(4.5)	75.0	3.1	16.0
Key Ratios (%)								
Int.inc./avg assets	6.9	7.5	7.1	7.2	7.1	8.0	7.7	7.7
Int. exp/avg assets	4.0	4.3	4.0	4.2	4.2	5.0	4.6	4.6
Net interest margin/Average assets	2.9	2.9	3.1	3.0	2.9	3.0	3.1	3.1
Non fund revenues/Avg assets	1.9	0.9	1.4	1.1	1.3	2.0	1.1	1.1
Core fee income / Avg assets	1.8	0.8	1.2	1.1	1.1	2.0	0.9	1.0
Operating expenses/avg assets	2.4	2.5	2.3	2.2	2.1	2.2	2.3	2.2
NPA Prov/avg assets	0.0	0.0	0.3	0.2	0.6	0.9	0.3	0.3
Tot prov/avg assets	1.1	0.3	1.0	0.5	0.9	1.0	0.5	0.5
PBT/avg assets	1.3	1.4	1.2	1.4	1.2	1.8	1.5	1.5
RoA	0.7	0.9	0.6	0.9	0.8	1.0	0.9	0.9
Tax/PBT	56.0	36.2	48.6	33.9	36.9	41.6	40.2	38.0

* Numbers for prior quarters are not comparable as a change in accounting policy has resulted in change in inter-categories, primarily netting off investment amortization expense from other income as appose to earlier method of taking it from provision line, per RBI circular dated April 20, 2007.

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6638 3300
Pathik Gandotra	Head of Research; Banking, Strategy	pathik@sski.co.in	91-22-6638 3304
Shirish Rane	Cement, Construction, Power, Real Estate	shirish@sski.co.in	91-22-6638 3313
Nikhil Vora	FMCG, Media, Retailing, Mid Caps	nikhilvora@sski.co.in	91-22-6638 3308
Ramnath S	Automobiles, Auto ancillaries	ramnaths@sski.co.in	91-22-6638 3380
Nitin Agarwal	Pharmaceuticals	nitinagarwal@sski.co.in	91-22-6638 3395
Ganesh Duvvuri	IT Services, Telecom	ganesh@sski.co.in	91-22-6638 3358
Varatharajan S	Oil & Gas, Engineering	varatharajan@sski.co.in	91-22-6638 3240
Chirag Shah	Textiles, Metals, Real Estate	chiragshah@sski.co.in	91-22-6638 3306
Bhoomika Nair	Construction, Power, Logistics	bhoomika@sski.co.in	91-22-6638 3337
Avishek Datta	Oil & Gas, Engineering	avishek@sski.co.in	91-22-6638 3217
Bhushan Gajaria	FMCG, Retailing, Media	bhushangajaria@sski.co.in	91-22-6638 3367
Shreyash Devalkar	IT Services, Telecom	shreyashdevalkar@sski.co.in	91-22-6638 3311
Nilesh Parikh, CFA	Banking	nilesh@sski.co.in	91-22-6638 3325
Veekesh Gandhi	Banking	veekesh@sski.co.in	91-22-6638 3231
Ashish Shah	Automobiles, Auto ancillaries	ashishshah@sski.co.in	91-22-6638 3371
Salil Desai	Cement, Infrastructure	salil@sski.co.in	91-22-6638 3373
Rahul Narayan	FMCG, Retailing, Media	rahulnarayan@sski.co.in	91-22-6638 3238
Suchit Sehgal	Mid Caps	suchitsehgal@sski.co.in	91-22-6638 3307
Nityam Shah	Automobiles, Auto ancillaries	nityam@sski.co.in	91-22-6638 3327
Dharmendra Sahu	Database Manager	dharmendra@sski.co.in	91-22-6638 3382

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6638 3300
Naishadh Paleja	CEO	naishadh@sski.co.in	91-22-6638 3211
GV Alankara	Head of Dealing	alankara@sski.co.in	91-22-6638 3201-210
Vishal Purohit	VP - Sales	vishalp@sski.co.in	91-22-6638 3212
Nikhil Gholani	VP - Sales	nikhilgholani@sski.co.in	91-22-6638 3363
Sanjay Panicker	VP - Sales	sanjaypanicker@sski.co.in	91-22-6638 3368
V Navin Roy	AVP - Sales	navin@sski.co.in	91-22-6638 3370
Rohan Soares	AVP - Sales	rohan@sski.co.in	91-22-6638 3310
Rishi Kohli	VP - Derivatives	rishikohli@sski.co.in	91-22-6638 3321/403
Pawan Sharma	AVP - Derivatives	pawansharma@sski.co.in	91-22-6638 3403
Dipesh Shah	AVP - Derivatives	dipeshshah@sski.co.in	91-22-6638 3403
Manohar Wadhwa	AVP - Derivatives	manohar@sski.co.in	91-22-6638 3403

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2. Neutral: Within 0-10% to Index
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