

May 14, 2007

ACCUMULATE

Price **Rs1,149** Target Price **Rs1,230**

Sensex **13,796**

Price Performance

(%)	1M	3M	6M	12M
Absolute	17	(5)	1	18
Rel. to Sensex	12	1	(3)	6

Source: Capitaline

Stock Details

Sector	Banks
Reuters	SBI.BO
Bloomberg	SBIN@IN
Equity Capital (Rs mn)	5263
Face Value	10
52 Week H/L	1,379/684
Market Cap	Rs604.8 bn/US\$14.8bn
Daily Avg Volume (No of shares)	1.9mn
Daily Avg Turnover (US\$)	46.7mn

Shareholding Pattern (%)

(31st Mar.'07)	
Promoters	59.7
FII	19.8
Institutions	11.0
Private Corp.	2.3
Public	7.2

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State Bank of India

Quarterly Update

Splendid performance

State Bank of India (SBI) has reported a net profit of Rs15.0bn for Q4FY07 which is line with our estimates. The operating performance was robust with NII growing by 21.5% yoy to Rs43.2bn, the fee income growth of 21% yoy to Rs23.3bn and operating profit growing by 34% yoy to Rs39.6bn. With lower effective tax rate, the net profit growing at 75% yoy to Rs15bn. Although the asset quality remains robust with gross NPA at 2.9% (3.9% last year) and net NPA at 1.6% (1.9% last year), the falling provision cover is likely to keep the NPA provisioning at a higher level.

At the current market price of Rs1,149, the stock is trading at 1.4x FY08E standalone ABV. We have upgraded our earnings estimates for FY08 and FY09 by 3.4% and 4.5% each to reflect robust improvement in operations. However, our fair value of Rs1,230, based on the 1.3x SAABV and Rs240 per share for subsidiaries leaves little on the table for investors. We change our recommendation to **ACCUMULATE** with price target of Rs1,230.

Strong growth in NII

SBI has reported a strong 27.6% yoy growth in NII to Rs43.2bn driven by 29% yoy (9.0% qoq) growth in advances and a 16bps yoy (7bps qoq) expansion in the NIM.

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Reported NII	43,201	35,546	39,513	21.5	9.3
Add: Reversal of int on adv IT		273			
Adjusted NII	43,201	35,819	39,513	20.6	9.3

Source: Company, Emkay Research

Driven by NIM expansion – but are they sustainable?

The strong growth in NII was driven by a strong 16bps expansion in NIM. However, the expansion in NIM do not seem sustainable as the higher yield on assets (up 132bps yoy) was partially contributed by activities in the short term money markets, the opportunity which may not be available in the coming quarters. Higher yields in the short-term money markets helped the banks to partly set off the higher cost of funds where there has been a significant jump driven by both the cost of deposits as well as borrowings. With no clarity on the tenure of the borrowings, we believe that the margins may not be sustained in coming quarters.

Yield analysis %	Q4FY07	Q4FY06	Q3FY07	Change in bps	
				yoy	qoq
Yield on assets	8.39	7.09	7.57	130	82
Cost of deposits	5.43	4.51	4.71	92	72
Cost of funds	5.25	4.12	4.50	113	75
NIM	3.14	2.98	3.07	16	7
NIM (Reported)	3.31	2.92	3.01	39	30

Source: Company, Emkay Research

Note: 1. Calculated on basis of average quarterly balances, 2. Reported NIM are on cumulative basis i.e., FY07, FY06 and M9FY07 respectively, 3. Adjusted for extraordinary items

CASA remains healthy

Despite a strong growth in balance sheet the CASA has remained healthy at 43.6% for Q4FY07.

Rs bn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Deposits	4,355	3,800	4,043	14.6	3.0
CASA	1,898	1,807	1,750	5.0	3.0
CASA (%)	43.57%	47.55%	43.29%		

Other income continues to remain healthy

The other income has grown by strong 22.6% yoy to Rs29bn driven by strong growth in fee income and receipt of dividend from subsidiaries during the quarter which usually accrues in the first quarter. Also there is a write back of the amortisation expenses of Rs4.5bn as the bank has redeemed excess investments in the HTM (SLR) portfolio resulting in the write back of excess provisions made during M9FY07.

Other income

Rs mn	Q4FY07	Q4FY06	% yoy chg
CEB	23,373	19,354	20.8
Treasury	382	800	-52.2
Forex	487	861	-43.5
Amortisation	4,549	-3,154	-
Dividend	2,218	23	-
Income From Leasing	-63	1	-
Others	-2,002	5,732	-
Total	28,943	23,616	22.6

Strong growth in adjusted operating profit

With a moderate growth of 10% in the operating expenses, the adjusted operating profit has grown by a strong 58.5% yoy to Rs39.7bn.

Core operating profit grows strong

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Reported operating profit	39,684	29,618	28,549	34.0	39.0
Add: Reversal of int on adv IT		273			
Less:					
Reconciliation gains		3,166			
One-time fee income		1,680			
Adjusted operating profit	39,684	25,045	28,549	58.5	39.0
Less: treasury gains	382	800	3,106		
Core operating profit	39,302	24,245	25,443	62.1	54.5

Source: Company, Emkay Research

Stable provisioning helps further

With stable provisioning, the net profit has grown by 75% yoy to Rs15bn. With significant improvement in profitability the NPA provisioning has also improved over last year at 0.22% of advances.

Provisions break up

Rs mn	Q4FY07	Q4FY06	% yoy chg
NPA	7,312	36	-
As % of advances	0.22%	-	
Investment depreciation	3,258	7,584	-57.0
Std assets	2,992	2,052	45.8
Others	564	565	-0.2
Total	14,126	10,237	38.0

Source: Company, Emkay Research

Provision requirement to remain high

The slight increase in the bank's gross NPA from Rs96bn to Rs100bn is in line with our expectations, which is driven by increased slippages in agricultural sector. The NPA provisioning was almost negligible over last few quarter which has also resulted in a very low provision cover of 47% (lowest in the industry). Resultantly, we believe that the NPA provisioning expenses are likely to remain high over next few quarters.

Capital adequacy comfortable...

SBI's Tier I CAR at the end of the quarter was a 8.0%, with still headroom left for quasi tier I capital of around Rs30bn. We believe that despite implementation of Basel II norms from April 2008, the bank will have comfortable tier I CAR.

... Equity issue could be trigger

The management has hinted at an equity issue by the end of CY2007, which can happen only once the State Bank of India Act is amended. The amendments have been ratified by the cabinet committee on economic affairs and have now to be ratified by the parliament.

Currently the RBI's (eventually government's, after the stake transfer) shareholding in SBI can go down upto 55%, which would allow the SBI to raise Rs54bn at prevailing market price and would be incremental to the FY08E book value by 6.4% (or Rs43per share).

The amendment would allow SBI to reduce the RBI's (eventually government's) stake in SBI from 59% currently to 51%, which would allow the bank to raise Rs108bn at prevailing market price and would be incremental to the FY08E book value by 12% (or Rs78per share).

Valuation and view

At the current market price of Rs1,149, the stock is trading at 1.4x FY08E standalone ABV. We have upgraded our earnings estimates for FY08 and FY09 by 3.4% and 4.5% each to reflect robust improvement in operations. However, our fair value of Rs1,230, based on the 1.3x SAABV and Rs240 per share for subsidiaries leaves little on the table for investors. We change our recommendation to ACCUMULATE with price target of Rs1,230.

The upside triggers for the stock could be:

- The amendment to the SBI Act which would allow the maximum equity dilution as mentioned above and would result in ~12% upside to our target price
- The amendment to the SBI Subsidiaries Act which would clear the way for merger of the subsidiaries banks into SBI.
- Exclusion of the GDR from the foreign shareholders category as they do not have the voting rights. However, this has not found its way into the SBI (amendment) Act.

Quarterly results

Rs mn	FY07	FY06	% yoy chg	Q4FY07	Q4FY06	Q3FY06	% yoy chg	% qoq chg
Net interest income	160,541	156,356	2.7	43,201	35,546	39,513	21.5	9.3
Other Income	57,691	43,850	31.6	28,943	23,616	18,110	22.6	59.8
<i>Fee income</i>	48,047	39,962	20.2	23,373	19,354	8,609	20.8	171.5
Net income	218,233	200,206	9.0	72,144	59,162	57,623	21.9	25.2
Operating expenses	118,235	117,251	0.8	32,460	29,544	29,074	9.9	11.6
Pre-provision profit	99,998	82,955	20.5	39,684	29,618	28,549	34.0	39.0
Provisions & Contingencies	24,096	13,428	79.4	14,126	10,237	11,662	38.0	21.1
<i>NPA</i>	14,295	1,478	867.1	7,312	36	4,106		78.1
Profit before tax	75,901	69,527	9.2	25,558	19,381	16,887	31.9	51.3
Taxes	30,490	24,995	22.0	10,626	10,847	6,237	-2.0	70.4
Net Profit	45,411	44,532	2.0	14,932	8,534	10,650	75.0	40.2

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	P/ABV (x)	PE (x)
FY2006	200,325	44,062	83.7	432.0	0.9	17.0	2.7	13.7
FY2007E	218,233	45,411	85.8	487.2	0.9	15.4	2.4	13.4
FY2008E	245,686	52,055	98.9	589.1	0.8	15.8	2.0	11.6
FY2009E	294,107	67,640	128.5	719.8	0.9	18.0	1.6	8.9

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