

## Company Flash

4 January 2008 | 9 pages

# State Bank of India (SBI.BO)

## Buy: Raising Deposit Rates – Why?

- Raises deposit rates – less than a month after dropping them:** SBI has raised its deposit rates – a relatively aggressive 25-225bps across maturities. This comes less than a month after it had dropped rates, albeit modestly. This bucks industry trends (no notable rate changes from peers, yet), and pushes SBI's deposit rates above average industry levels. There are no lending rate changes
- Why? Why? Why?:** Possible rationale for the quick about turn, and the increase; a) SBI's current market share gain philosophy; b) Pre-emptive move into the 4<sup>th</sup> quarter, when liquidity usually generally tightens; and c) Delayed response to tight funding markets in December (now eased). Our take — bad for SBI's margins (under pressure, even without this); negative for the industry – starting deposit pricing competition without meaningful asset pricing power; and at-least from our perspective (smaller picture ?)– not very rational.
- Most likely – SBI being pro-active, in an inevitably/progressively tight 4<sup>th</sup> quarter?** 4<sup>th</sup> quarters suggest a pattern/seasonality – strong loan growth, attendant liquidity squeeze, and high cost fights for deposits (and stock under-performance in 2 of last 3 years). But this year, pressures appear lower; incremental loan deposit ratio under 50%, comfortable market liquidity, falling bonds yields (-20bp last fortnight) and lower interest rate trends globally. The Risk – a costly scramble for deposits, when there is enough going around.
- Margins should hurt – should the stock?** SBI's moves a possible mix of industry developments (data releases on 4<sup>th</sup> Jan), its funding position and strategy; we however, see it hurting SBI's margins, its stock, & possibly the broader sector.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (03 Jan 08)	Rs2,393.75
Target price	Rs2,430.00
Expected share price return	1.5%
Expected dividend yield	0.7%
<b>Expected total return</b>	<b>2.2%</b>
Market Cap	Rs1,259,828M
	US\$32,044M

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



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	44,067	83.78	2.4	28.6	4.6	17.1	0.6
2007A	45,414	86.31	3.0	27.7	4.0	15.4	0.6
2008E	54,018	102.64	18.9	23.3	3.5	16.1	0.7
2009E	63,778	121.18	18.1	19.8	3.1	16.6	0.7
2010E	76,209	144.80	19.5	16.5	2.6	17.2	0.7

Source: Powered by dataCentral

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**Figure 1. SBI Effective Interest Rates**

Period	Aug'07 %	Nov'07 %	Dec'07 %	Jan'07 %	Change in Dec'07, bps	Change in Jan'07, bps
15- 45	5.00	5.00	4.75	4.75	-0.25	0.00
46-90	5.50	5.50	5.25	5.25	-0.25	0.00
91-180	5.50	5.50	5.25	7.00	-0.25	1.75
181-271	5.50	5.50	5.25	7.50	-0.25	2.25
271-1 yr	6.75	6.75	6.50	7.50	-0.25	1.00
1-1.5yrs	8.00	8.00	8.25	8.75	0.25	0.50
1.5 yrs	8.00	8.75	8.50	8.75	-0.25	0.25
1.5-2 yrs	8.00	8.00	8.25	8.75	0.25	0.50
2-3 yrs	8.25	8.25	8.25	8.50	0.00	0.25
3 yrs & above	8.50	8.50	8.50	8.50	0.00	0.00

Source: Company Reports and Citi Investment Research

**Figure 2. SBI Deposit Maturity Profile**

Period	Interest rates Jan'07, (%)	Change in Jan'07 ( bps)	Deposits maturity Profile Mar'07 , (Rs M)	Percent Of deposits
15- 45	4.75	0.0	622220.1	14%
46-90	5.25	0.0	179803.5	4%
91-180	7.00	1.75	182663.4	4%
181-1 yr	7.50	2.25 -1.00	403936.1	9%
1-3 yrs	8.75	0.25-0.50	1200105.3	28%
3 yrs & above	8.50	0.25	1766482.4	41%

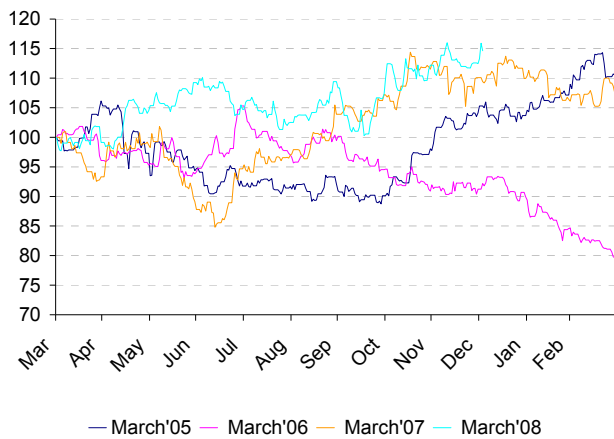
Source: Company Reports and Citi Investment Research

**Figure 3. SBI and Peers Comparable Interest Rates**

Period	SBI	ICICI bank	PNB	HDFC Bank
15- 45	4.75	4.00	4.75	5.50
46-90	5.25	4.00	5.75	5.50
91-180	7.00	6.25	6.00	6.00
181-271	7.50	6.25	7.25	6.75
271-1 yr	7.50	6.25	7.25	6.75
1-1.5yrs	8.75	8.50	8.50	8.00
1.5 yrs	8.75	8.75	8.50	8.00
1.5-2 yrs	8.75	8.00	8.50	8.00
2-3 yrs	8.50	8.00	8.50	8.25
3 yrs & above	8.50	8.50	8.50	8.25

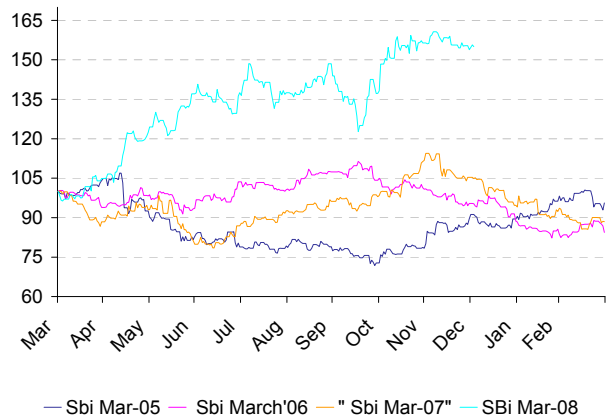
Source: Company Reports and Citi Investment Research

Figure 4. Bankex relative to Sensex seasonality



Source: Citi Investment Research

Figure 5. SBI relative to Sensex seasonality



Source: Citi Investment Research

## State Bank of India

### Company description

SBI is India's largest bank with around 20% market share in deposits and loans, 9,038 branches and more than 90m customers. Together with its seven associate banks (ownership ranging from 75% to 100%), the SBI group has more than 26% market share in deposits and 24% in loans, and has 13,635 branches. SBI has the largest overseas presence among Indian banks, with 54 offices in 28 countries. The Reserve Bank of India owns 59.73% 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 with GE Capital for credit cards. It also has a presence in asset management, investment banking and primary dealership. The SBI group has more than 6000 ATMs spread, the largest in the country. The bank has more than 28m cards outstanding, is networked across over 10,000 offices of the SBI group and is aggressively expanding its technology based offering, across its existing network.

### Investment strategy

We rate SBI Buy (1L). SBI has aggressively restructured in terms of manpower, technology and business focus. It should be a significant beneficiary of the expected increase in loan demand in India, spread across the consumer sector and in the industrial segment. SBI appears to have sustainable ROEs of 15-17%.

### Valuation

Our target price for SBI is Rs2430 (previously Rs1825) is based on our EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for Citi's India Banking universe. We use a risk-free rate of 8% in line with the market level and value the company's subsidiaries at Rs645 (previously Rs525) based on valuation benchmarks for FY09E and after factoring in the Insurance and asset management business. Our target price upgrade is premised on higher subsidiary valuation (Insurance at Rs241 per share and associate banks at 1.5X PBV), higher longer term expectations for fee income growth, asset yields and lower costs than our previous valuation.

Our valuation for SBI is also benchmarked off a P/BV of 2x FY09E for the parent (1.5x previously) and 1.5x FY09E (1.25X FY09E, previously) for the associate banks, and we factor in Rs241 (Rs140 previously) per share for the Insurance company, and Rs15 for the Asset management companies. This translates to a value of Rs2000 per share. We are basing our target price on EVA as P/BV for the consolidated entity will require more consistent and predictable reporting by management. We are also consistently using the EVA measure as our primary methodology as we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business.

## **Risks**

We rate SBI Low Risk based on our quantitative risk-rating system. The downside risks to our target price lie in: (1) A sharp rise in interest rates; (2) Asset quality concerns given strong loan growth; (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

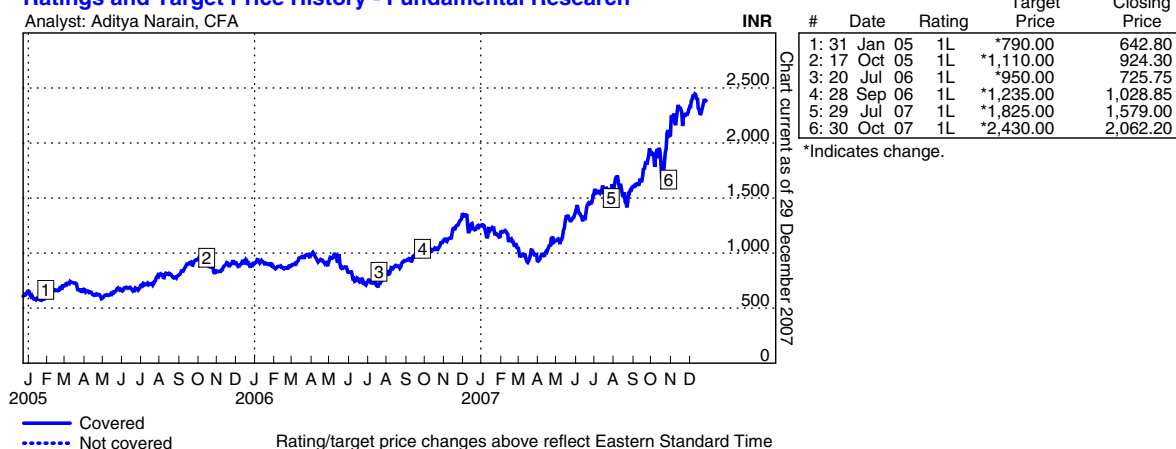
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Analyst: Aditya Narain, CFA



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

4 January 2008

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ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

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