State Bank of India SBIN IN

FINANCIALS/BANKS | INDIA

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Maintained

BUY

NOMURA
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Action

We are upgrading our price target for SBI to Rs3,765 as we roll over our EPS to FY12F, consider the likely equity infusion of US$5bn and increase our P/BV multiple to 2x from 1.5x. The change in multiple is driven by an improved NIM outlook and clarity on shortfall provisioning. Maintain BUY.

Catalysts

Expected strong 18% y-y earnings growth for 2QFY11 despite MTM losses, stable NIM outlook which is questionable for some other banks, and likely listing of its life insurance business in FY12.

Anchor themes

Loan growth has moderated in 2QFY11 for the sector. While deposit growth has picked up, it remains lower than expected. Bond yields have increased over June. We recommend banks with strong deposit franchises and an improving loan market share.

Closing price on 27 Sep	Rs3,181
Price target	**Rs3,765**
	(from Rs2,590)
Upside/downside	18.6%
Difference from consensus	15.6%
FY11F net profit (Rsmn)	117,001
Difference from consensus	4.5%

Source: Nomura

Nomura vs consensus

The difference in earnings is marginal, driven by somewhat higher NIM assumptions. The difference in PT largely reflects dilution.

Upgrading PT, still a BUY

① Upgrading PT to Rs3,765

We are upgrading our price target to Rs3,765, as we roll over our EPS to FY12F, factor in the equity dilution of US$5bn that is likely to happen before March 2011, and increase our target multiple from 1.5x to 2x for the parent bank and from 1.5x to 1.8x for the associate banks. Pre-dilution, our PT has been revised by 35%; including the dilution, our PT revision is 45%. We believe that even post dilution, SBI can trade at the pre-dilution multiple, as it has a track record of leveraging new funds within one to two years. After a 20% dilution in March 2008, SBI's RoE was 17.1% in March 2009.

② Increase in target multiple, led by improved NIM outlook

The key driver of our increased target P/BV multiple is the improved outlook for margins, with SBI refocusing on retail deposits and savings accounts rather than bulk deposits. We revise our sustainable NIM to 2.6% from 2.5% earlier.

③ BUY SBI for valuations, strong core in 2Q

At 2.7x P/BV and 17x P/E, SBI is still inexpensive relative to private and other state banks. We find the risk-reward attractive, given the expected strong core growth of 47% y-y in 2QFY11F. We expect net profit will grow a strong 27% in FY11F and 22% in FY12F. We expect SBI will list its life insurance business in FY12.

④ 2QFY11F – Net to grow 18%, core to grow 47%

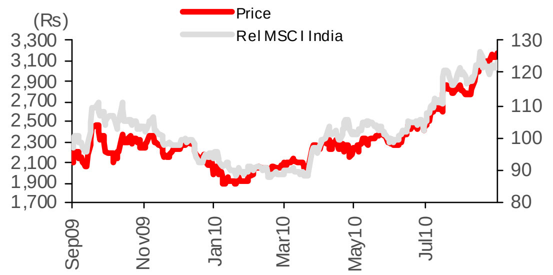
We estimate net profit growth of 18% y-y (flat q-q) for 2QFY11F. We expect NIM will expand 8bps q-q driven by better loan yields. Core operating growth should be strong at 47% y-y. But the bank will also book MTM losses of Rs4bn, we estimates, resulting in net profit growth being lower (but still strong) at 18% y-y.

Key financials & valuations

31 Mar (Rsmn)	FY09	FY10F	FY11F	FY12F
PPOP	-	-	-	-
Reported net profit	91,212	91,661	117,001	142,951
Normalised net profit	91,212	91,661	117,001	142,951
Normalised EPS (Rs)	143.7	144.4	184.3	225.2
Norm. EPS growth (%)	34.8	0.5	27.6	22.2
Norm. P/E (x)	22.1	22.0	17.3	14.1
Price/adj. book (x)	3.48	3.06	2.67	2.30
Price/book (x)	3.48	3.06	2.67	2.30
Dividend yield (%)	0.9	0.9	0.9	1.1
ROE (%)	17.1	14.8	16.5	17.5
ROA (%)	1.08	0.91	1.01	1.04
Earnings revisions				
Previous norm. net profit		100,990	110,050	150,631
Change from previous (%)		(9.2)	6.3	(5.1)
Previous norm. EPS (Rs)		159.1	173.3	237.3

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	13.8	38.2	53.4
Absolute (US$)	18.6	42.2	54.2
Relative to Index	2.9	26.7	42.4
Market cap (US$mn)			44,862
Estimated free float (%)			30.4
52-week range (Rs)			3,181/1,895
3-mth avg daily turnover (US$mn)			120.1
Stock borrowability			Hard
Major shareholders (%)			
Govt of India			59.4

Source: Company, Nomura estimates

Drilling down

Upgrading price target to Rs3,765

Our upgrade is driven by the following factors:

- Rollover of BVPS to FY12F.
- Likely 13% equity dilution of US$5bn, at an expected issue price of Rs2,800.
- For FY12F, our standalone pre-dilution BVPS is Rs1,381, BVPS of the associate banks is Rs386 and book value per share of investments in subsidiaries is Rs67. Post dilution BVPS for FY12F will likely be Rs1,542 for the parent bank and Rs343 for the subsidiaries.
- Change in target P/BV multiple from 1.8x to 2x for the parent bank, driven by an improved outlook for NIMs. Over the past three quarters SBI has shown the willingness to shed high-cost deposits in favour of retail term deposits and savings deposits. The rapid branch expansion undertaken over the past two years, wherein SBI added 1,500 new branches will, in our view, ensure that growth in savings deposits will continue, giving us the comfort to raise sustainable margins (net interest income divided by average assets) to 2.6% from 2.5%. Likewise, we have changed the P/BV multiple for its banking subsidiaries from 1.5x to 1.8x.
- For our earlier price target, we had deducted the provisioning shortfall of Rs130 per share from SBI's book value as there was no clarity on the timeframe by which SBI would meet the required 70% cover. However, with clarity having emerged (SBI will amortise the provisioning shortfall through the profit and loss account by September 2012), we have taken the higher provisions through the profit and loss account.
- We have tweaked our value of its non-banking subsidiaries. Our fair value of its subsidiaries has declined marginally from Rs231 per share to Rs225 per share. The major change, however, is in the life insurance valuation, where we have lowered our multiple, and new business margin, which have been partly offset by a rollover of base to FY12F as explained later.

The following table provides a breakdown of the increase in price target from various factors.

Exhibit 1. Breakdown of increase in price target

	INR per share	% to total
Standalone bank	204	5
Subsidiaries	71	2
Shortfall in provisions no longer required	130	3
Fair value of non-banking subsidiaries	-6	0
Change in multiple	531	14
Total change in price target pre dilution	930	25
New price target pre-dilution	3,520	93
Add impact of dilution	245	7
Total change in price target, post dilution	1,175	100
New price target, post dilution	3,765	
Old price target	2,590	

Source: Company data, Nomura estimates

No change in target multiple pre- and post-issue: We expect SBI will complete an equity offering by March 2011. SBI has already officially written to the government for a rights issue. SBI's last equity offering was in March 2008 with dilution of 20%. In the year following the issue, RoE was already 17%. SBI has, in the past, been successful at keeping its leverage high given its strong corporate relationships, strong retail brand image and wide branch network. As such, we do not see the need to revise down our sustainable RoE assumption in our post-dilution valuation. We value SBI at 2x P/BV FY12F.

Basis of valuation: We value the parent bank at 2x P/BV FY12E based on a sustainable RoE of 17.6% and CoE of 12.2%. We value the subsidiaries at 1.8x P/BV FY12F. Our appraisal value for its life insurance business assumes 12x new business profit for FY12F. We have valued the asset management business at 4.7% of existing AUM.

Exhibit 2. Sum-of-the-parts valuation

SBI Standalone	Value (INRmn)	INR per share
Core banking business		**3003**
Non-banking subsidiaries		
SBI Life	167,932	174
SBI MF	19,492	17
NSE	117,000	13
UTI MF	32,087	6
SBI Caps Securities	1,231	1
SBI Capital Markets	18,162	25
Value of non-bank subsidiaries		237
Value of non-bank subsidiaries, post hold co discount		201
Value of associate banks		**562**
State Bank of India: 12-month value		**3766**

Source: Company data, Nomura estimates

Exhibit 3. Derivation of price target

(%)	Old target	Target pre-dilution	Target post-dilution
Net interest inc/assets	2.5	2.6	2.6
Non-interest inc/assets	1.2	1.2	1.2
Non-operating profits /assets	0.2	0.2	0.2
Opex / assets	1.8	1.8	1.8
Oper profits/assets	2.1	2.2	2.2
Provisions/assets	0.6	0.7	0.7
Other/assets			
(1-tax rate)	65.0	67.0	67.0
Minorities/assets			
RoA	1.0	1.0	1.0
Assets/equity, x	17.5	17.5	17.5
RoE	17.1	17.6	17.6
Risk-free rate	6.5	7.5	7.5
Risk premium	4.5	4.5	4.5
Beta	1.2	1.1	1.1
CoE	12.0	12.2	12.2
Growth,%	6.0	7.0	7.0
Target P/BV, x	1.8	2.0	2.0
BVPS of standalone bank, INR	1,177	1,381	1,542
Less provisioning cover, INR	130	0	0
Less investments in subsidiaries, INR	80	67	60
Net BVPS, INR	966	1,313	1,482
Fair value of the standalone banking business, INR	1,778	2,661	3,003
Fair value of the banking subsidiaries	579	632	562
Value of non-banking subsidiaries, INR	231	225	200
Consolidated fair value, INR	2,587	3,518	3,765
Rounded off to, INR	2,590	3,520	3,765

Source: Company data, Nomura estimates

Exhibit 4. Valuation methodology

	Basis of valuation - NEW	Basis of valuation - OLD
Parent bank	P/BV of 2x FY12E. RoE of 17.6%, CoE of 12.2%.	P/BV of 1.8x
SBI Life	Appraisal value. NBP margin of 10.5%, premium growth of 25% in FY11E, 25% in FY12E and 20% in FY13E. NBAP multiple of 12x FY12E.	Appraisal value. NBAP multiple of 16x and NBAP margin of 15%
SBI MF	17x FY12 P/E implying 4.7% of Assets Under Management.	6% of Assets under Managements
NSE	Market benchmark	Market benchmark
UTI MF	12x FY12 P/E	12x one year forward PE
SBI Caps Securities	10x FY12 P/E	10x one year forward PE
SBI Capital Markets	10x FY12 P/E	10x one year forward PE
Associate banks	1.5x P/BV FY12E	1.5x P/BV one year forward

Source: Company data, Nomura estimates

Exhibit 5. SBI Life: valuation

	FY2008	FY2009	FY2010F	FY2011F	FY2012F	FY2013F
Paid-up capital brought forward	5,000	10,000	10,000	12,652	14,244	16,074
New capital infusion	5,000	0	2,652	1,591	1,830	2,105
End of the year capital	10,000	10,000	12,652	14,244	16,074	18,178
Less accumulated deficit	0	216	0	0	0	0
Total shareholders fund	**10,000**	**9,784**	**12,652**	**14,244**	**16,074**	**18,178**
Opening balance of VIF business	7,321	13,494	22,219	34,644	47,890	64,049
New business premium income	34,812	46,469	63,576	79,470	99,338	114,239
NBAP margin,%	15.0	15.0	15.0	11.0	10.0	10.0
New Business value	5,222	6,970	9,536	8,742	9,934	11,424
Inforce business unwinding (13%)	952	1,754	2,888	4,504	6,226	8,326
Estimated VIF at close of the year	13,494	22,219	34,644	47,890	64,049	83,799
Y/e EV	**23,494**	**32,003**	**47,296**	**62,133**	**80,123**	**101,978**
EV as % of fair value			**26%**			
Value of new business					119,206	
Value of inforce business					47,296	
Embedded value					**166,502**	

Source: Company data, Nomura estimates

SBI Life Insurance

Stronger-than-sector growth in new premium will continue: SBI Life insurance continues to outperform its peers in terms of growth in new business premium. In the first five months of FY11, SBI's new business premium grew 70% y-y. We expect SBI will record strong 25% growth in new business premium in FY12F, while other players struggle to keep their premium income flat, given that SBI already extensively uses bancassurance relative to other players which implies that it will not have to make significant changes to its distribution network unlike other players.

Margins will continue to be lower than the overall sector, due to group gratuity business: SBI has a different business mix compared with other players. It has a higher proportion of group business, especially group gratuity business. Of all the insurance businesses, the group gratuity business is the least profitable. SBI has the highest proportion of the group gratuity business among life insurance players at 28% in FY10. Of the total premium of close to Rs70bn, group gratuity premium was Rs20bn in FY10. This implies that SBI's new business margins are lower, compared with 18-20% for the sector. Alhough SBI has not disclosed its new business margin, we estimate the same at 15% for FY10F.

Margins will likely decline due to negative regulatory changes, but the decline will be lower than other life insurers: With new regulatory changes in life insurance, we expect SBI's new business margins (NBM) will come off by 15%. The decline in SBI's new business margin is likely to be significantly lower, compared with other players, which are expected to record a 30-35% decline in NBMs. As SBI already has lower surrender charges and lower payouts to agents, compared with the rest of the sector, its margins should be least impacted, in our view. Apart from the 15% decline in NBM, SBI, like other insurance companies, will also be subject to a higher corporate tax rate of 30%, effective FY13F once the proposed direct tax code becomes effective. The current tax rate for life insurance companies is 14%. We expect SBI's new business margins will decline to 12.75% from 15.0% on account of new regulatory changes, and further to 10.5% on account of the new tax code. We have valued SBI Life based on a new business margin of 10.5%.

Valuing the life insurance business: We have valued SBI's new life insurance business at 12x new business profit for FY12F. We have assumed premium growth of 25% for FY11F, 25% for FY12F and 20% for FY13F. Our embedded value for SBI is Rs47bn for FY10. The total appraisal value of the life insurance business works out to Rs166.5bn. SBI owns a 74% stake in its life insurance venture.

Achieved expense breakeven in FY09: Given its low cost structure, SBI Life already achieved expense breakeven in FY09, much ahead of all new players in this field. SBI has a lower cost structure owing to the higher contribution from bancassurance, compared with other players. SBI's total payouts to agency channels are lower than competition. SBI Life is already a profitable life insurance company unlike most other players that are still coping with new business strain.

Exhibit 6. SBI Life Insurance – net profit

(INRmn)	FY06	FY07	FY08	FY09	FY10
Net profit	20	38	340	260	2,760

Source: Company data, Nomura estimates

SBI Life – likely to be listed in FY12F: Based on our discussions with SBI Life management, we expect the company will be listed in FY12. Management awaits IPO norms and is keen to list the company in FY12. SBI has not yet disclosed the embedded value or even new business margins. It plans to disclose these when the new IPO norms are announced. We note that there is no clarity on the relaxation of foreign holdings in life insurance companies, as yet. There is a pending proposal to increase the foreign holding limit in insurance companies from the current 26% to 49%; however, this has not been cleared by the Parliament for a long time now. Pending such approval, any listing will have to be a domestic issue or an offer for sale by the promoters.

2Q earnings preview: strong growth despite MTM losses: We expect SBI will record strong 18% y-y growth in net profit for 2QFY11F. Loan growth has moderated for SBI and, for the sector as a whole, in 2QFY11 due to weak demand for working capital and a lack of pick-up in project loans. Corporates have been financing their needs through equity issuances. Furthermore, most corporates also appear to be holding back on capacity expansions given a weak global outlook. We expect SBI will record moderate 2.0% q-q growth in 2QFY11, slower than the 3.5% seen in 1QFY11. However, we expect NIMs will improve due the lagged impact of deposit repricing and the positive impact of a hike in lending rates. While the hike in lending rates will increase overall loan yield by around 30bps, new higher deposit rates will reflect in earnings very gradually on repricing. We expect around 36% of SBI's deposits will be repriced over the next one year. We expect NIM to improve by close to 10bps q-q from 3.18% in 1QFY11. We also expect SBI will book mark-to-market (MTM) losses of Rs4bn in 2QFY11F against MTM write-backs in 1QFY11. Despite MTM losses, we expect SBI will record robust 18% y-y growth in net profit driven by better NIMs, lower costs and controlled operating expenses. We estimate growth in core operating profit y-y will remain strong at 47%; net profit will likely remain flat q-q due to MTM losses, while core operating profit will grow a strong 6%.

Exhibit 7. 2QFY11F earnings summary

(INRmn)	2QFY11F	2QFY10	1QFY11	%y-y	%q-q
Net interest income	76,689	56,088	73,037	37	5
Commission	25,867	21,030	24,096	23	7
Trading gains	2,500	5,454	1,734	(54)	44
Forex income	5,126	5,237	5,025	(2)	2
Dividend	1,500	1,682	3,772	(11)	(60)
Leasing income	0	0	9		
Other income	2,250	1,848	2,263	22	(1)
Total non-interest income	37,243	35,252	36,899	6	1
Payment to employees	22,957	23,602	14,507	(3)	58
Contribution to employees	7,000	2,739	16,233	156	(57)
Employee expenses	29,957	26,341	30,739	14	(3)
Rent	0	3,906	3,878		
Depreciation	0	2,078	1,972		
Others	0	10,664	12,000		
Other operating expenses	18,385	16,648	17,850	10	3
Total operating expenses	48,342	42,990	48,589	12	(1)
Operating profit	65,590	48,350	61,347	36	7
Core operating profit	63,090	42,897	59,613	47	6
Loan loss provisions	16,000	9,974	17,334	60	(8)
Standard assets provisions	1,060	-87	1,059		
Investment depreciation	4000	-494	-2,983	NA	(234)
Other provisions	104	767	104	(86)	0
Provisions	21,164	10,161	15,514	108	36
PBT	44,676	38,190	45,833	17	(3)
Core PBT	41,926	32,736	44,099	28	(5)
Tax	15,190	13,289	16,688	14	(9)
Net profit	29,486	24,900	29,146	18	1

Source: Company data, Nomura estimates Note: 2QFY11F ex-SBI Indore to facilitate like-for-like comparison

State Bank of Indore merger may distort 2Q earnings: SBI Indore, an associate bank, has already been merged with SBI effective 2QFY11. We believe the merger will not impact the consolidated numbers, but will affect SBI's standalone earnings that are more widely tracked than the consolidated numbers. SBI Indore has a loan book of Rs250bn that will add around 4% to the parent book. The last reported non-performing loans (NPL) of SBI Indore will likely add 24% to the parent's (SBI) existing NPLs. In 1QFY11, SBI Indore's net profit declined 77% y-y to Rs180mn. As such, the contribution to profit from the merger, based on 1Q numbers, is negligible at 0.6%. For the full-year FY10, the merger of SBI Indore added 3.4% to SBI's standlone numbers. SBI will report merged numbers in 2Q, which will not be comparable to the unmerged numbers of the previous quarters. Therefore, loans and NPLs will look inflated in 2Q. Note that our forecasts in the above table are for SBI parent, without the merger of SBI Indore, to facilitate a like-to-like comparison.

Exhibit 8. State Bank of Indore merger

	SBI Indore	SBI	Consolidated	% increase from merger
Gross NPLs (Rs Mn)	4,929	20,825	25,754	23.7
Net profit (Rs Mn)	180	29145.5	29,326	0.6
Loans (Rs.Bn)	250	6532.2	6,782	3.8
Shareholders' funds	18	659	678	2.8

Source: Company data, Nomura estimates

NIM's likely to rise in 2Q and then stabilise – upside risks from faster-than-expected growth in savings deposits: SBI's reported NIMs improved substantially from a low of 2.3% in June 2009 to 3.2% in June 2010. We expect NIMs will continue to improve in 2QFY11F as explained above by 10bps. This, we believe, will be a good achievement in an environment where incremental NIMs for the sector are under pressure due to higher rates on bulk and retail deposits. Post 2Q, we expect NIMs will stabilise. We also believe there is stronger visibility on SBI achieving its forecast NIMs given the sustained growth in savings deposits led by the recent branch expansion.

SBI's savings deposits have grown at a CAGR of 29.2% over FY08-FY10. The growth in savings has been particularly strong over the past three quarters, with robust growth of 34% in 1QFY11. We expect savings deposits will grow 19% over FY10-FY12F p.a. We see upside risks to our growth estimates for savings deposits going by the recent momentum, but are currently building in lower forecasts owing to growing competition. Higher-than-expected savings deposits should lead to higher net interest margins (NIMs) in the coming quarters.

Exhibit 9. SBI: net interest margins

Year	NIM, %
FY06	3.45
FY07	2.83
FY08	2.82
FY09	2.63
FY10	2.46
FY11F	2.80
FY12F	2.77

Source: Company data, Nomura estimates

Strong deposit franchise: SBI's deposit franchise remains amongst the best in the industry. The proportion of Current Accounts and Savings Accounts (CASA) deposits improved to 47% in FY10 from 41% in FY06. The proportion of bulk deposits to total deposits declined to 1.7% in FY10 from 2.8% in FY08 – the lowest in the sector. The proportion of deposits that will reprice within one year at 36% for SBI is amongst the lowest in the sector, which is an added positive in a rising rate environment, we believe. The growth in savings deposits was close to 30% in FY10 and a strong 34% y-y in 1QFY11. These growth rates are amongst the highest in the sector, despite SBI's large market share. On all parameters of deposit mix, SBI is well ahead of competition, we believe.

Exhibit 10. Deposit repricing in one year

(INRmn)	Deposits up to one year	% of total deposits
Axis Bank	780,489	55.2
Bank of India	1,334,772	58.1
HDFC Bank	489,032	29.2
ICICI bank	969,511	48.0
Punjab National Bank	912,032	36.6
SBI	**2,882,038**	**35.8**
Union Bank	667,537	39.3
Allahabad	542,001	51.1
Corporation Bank	505,473	54.5
Canara	1,247,510	53.2
Yes Bank	221,477	82.6
United Bank	284,459	41.7
Bank of Baroda	1,469,112	60.9
Indusind Bank	175,054	65.5

Source: Company data, Nomura estimates

Exhibit 11. Quarterly savings deposits growth

(INRmn)	Savings Deposits	% y-y	% q-q
1Q08	1,359,330	13.0	5.3
2Q08	1,388,830	27.2	2.2
3Q08	1,467,620	15.0	5.7
4Q08	1,542,293	19.0	5.1
1Q09	1,710,990	25.6	10.9
2Q09	1,764,960	27.1	3.2
3Q09	1,857,990	26.6	5.3
4Q09	1,982,243	29.8	6.7
1Q10	2,121,530	23.9	7.3
2Q10	2,216,999	25.6	4.5
3Q10	2,455,334	32.1	10.8
4Q10	2,574,603	29.9	4.9
1QFY11	2,839,668	33.9	10.3
Average growth		**24.6**	**6.0**

Source: Company data, Nomura estimates

Asset quality – slippages likely to remain at 2.0-2.2%: New NPLs for SBI came in at 2.2% for FY10 and 2.5% (ex farm waiver) for 1QFY11F. Management indicates that slippages will remain at above 2% for SBI due to technical NPLs in the retail segment and slippages in farm loans and SMEs. We expect slippages will remain high at 2.2% in FY11F and then come down to 1.9% by FY12F. While new NPLs will rise, we expect SBI will make significantly higher provisions y-y in order to meet the Reserve Bank of India's (RBI) mandated loan loss cover of 70%. The following tables highlight the stressed assets of SBI.

Exhibit 12. Quarter-wise restructured loans

(INRBn)	Loans restructured during the period	As a percentage of total loans
FY09	108	1.99
1QFY10	60	1.11
2QFY10	62	1.08
3QFY10	8	0.13
4QFY10	37	0.59
FY10	107	1.69

Source: Company data, Nomura estimates

Exhibit 13. Restructured loans

Outstanding restructured loans as of June 2010, Rsbn	268
of which loans restructured under RBI scheme, Rsbn	168
Slippage on restructured loans under the RBI scheme, Rsbn	18
Slippage on restructured loans under other schemes, Rsbn	9
Total slippage, Rsbn	27
Slippage, %	9.90
Total loans as of June 2010, Rsbn	6,532
Restructured loans / Total loans	4.10

Source: Company data, Nomura estimates

Exhibit 14. Movement in NPLs (INRbn)

Opening gross NPA	**100**	**128**	**157**	**195**	**242**	**271**
Add slippage	79	111	118	139	136	160
Less recovery	51	30	21	25	30	36
Recovery as % of last year's loans		0.71	0.38	0.40	0.40	0.40
Less upgrade		34	40	47	57	67
Upgrade as a percentage of last year's loans		0.82	0.73	0.75	0.75	0.75
Less write-offs		19	20	20	20	20
Write offs as a percentage of last year's loans		0.45	0.37	0.32	0.26	0.22
***Less* total reduction**	**51**	**83**	**80**	**93**	**107**	**123**
Closing gross NPAs	128	157	195	242	271	309
Write-offs						
Gross NPAs-Provs	74	97	109	110	94	76
Provisions/gross NPLs , %	42.2	38.4	44.4	54.6	65.4	75.3
Provisions / gross NPLs, after technical write offs, %	0.0	57.0	59.2	65.0	72.6	79.9
Slippage / previous year's loans, %	**2.3**	**2.7**	**2.2**	**2.2**	**1.8**	**1.8**

Source: Company data, Nomura estimates

Earnings outlook, pre dilution:

- We estimate NIM of 2.8% in FY11F and 2.77% in FY12F, against 2.46% in FY10.
- We expect NII will grow 31.2% in FY11F and 17.8% in FY12F, against growth of 18% over FY08-FY10.
- We have assumed credit cost of 106bps in FY11F and 89bps in FY12 F, against 88bps in FY10.
- We expect gross NPLs will rise 24% y-y in FY11F and 12% in FY12F. Gross NPLs grew 23% for SBI over FY08 to FY10.
- We expect tier-I CAR of 8.8% in FY11F and 8.6% in FY12F, against 9.4% in FY10 and 9.79% in 1QFY11.
- We expect core fees to grow 22% in FY11F and 20% in FY12F.
- We expect core operating profit will grow 49% in FY11F and 21% in FY12F against 6% in FY10.
- We expect operating profit will grow 40% in FY11F and 18% in FY12F.
- We expect net profit will grow 27% in FY11F and 22% in FY12F.

Risks to our earnings and price target

Slower-than-expected loan growth: We believe slower-than-expected loan growth is the biggest risk to our earnings expectations for SBI and other banks. While loans grew 3% q-q in 1QFY11, largely driven by one-time telecom funding, loan growth has moderated in 2Q and is running low at just 1.2% q-q for the sector. Likewise, for SBI, loan growth is slower than expected, due to the slower-than-expected offtake in project loans, scaling down of capacity expansion by corporates owing to a weak global outlook, refocus on external commercial borrowings by corporates in the recent past and increased reliance on equity funding given strong equity markets. Slow loan growth will not impact 2Q earnings because higher NIMs will offset slower growth. However, for earnings to remain strong, loan growth needs to pick up from 3Q. We expect loan growth to pick up in 2H with higher retail loans during the festival season and better offtake of project loans. We believe this is the key monitorable for banks.

Exhibit 15. Sector loan growth versus SBI

	SBI	Sector
YTD, %	4.30	3.40
y-y, %	21.40	19.40
Over Jun 2010,%	0.40	1.20

Source: Company data, Nomura estimates

Deposit growth needs to pick up, but RBI can manage rates and liquidity: Money supply and deposit growth at 14% are running lower than the RBI's target of 18%. The key reason for the slow deposit growth is high inflation, which impacts real returns. While there is no concrete data available and this will be available only with a lag, RBI and banks believe that with negative real deposit rates, depositors are investing in real estate / cars / gold. In addition, while foreign flows are strong and should have a positive impact on money supply, this is offset by a high trade deficit. Banks have already increased deposit rates and are refocusing on branch expansion, which should have a positive impact on deposit growth over the next three to six months, in our view. In addition, we expect inflation will decline to 6-7% in early FY12F, which will also make deposits attractive relative to other investments. Overall, we believe RBI can infuse the required liquidity into the market once inflation falls closer to 6-7%, which will likely happen over 4QFY10-1QFY11F.

Bond yields: We expect long-term rates to correct by 40-50bps by December-January 2011F to reflect global weakness in economic growth. Short-term rates will be driven by liquidity. RBI is currently in favour of maintaining tight liquidity owing to inflationary pressures. Such a stance, we believe, will likely change only when reported inflation comes down to 7% or lower, which is unlikely to happen before end-FY11E, in our view. We expect short-term rates will remain close to current levels until then. Overall, we believe banks will record MTM losses in 2QFY11 that can be offset through higher trading gains in 2HFY11.

Price performance: SBI has outperformed the SENSEX by 24% and the Bankex by 2% YTD. Over the past three months, SBI has outperformed the SENSEX by 21.3% and the Bankex by 8%. The price performance has been driven by strong 1Q earnings and SBI's attractive valuations.

Peak, average and current valuations: SBI trades at 1.7x P/consolidated banking BVPS for FY12F. While calculating the consolidated multiple for the core bank, we have deducted Rs225 as value of the non-bank subsidiaries from the market price and deducted Rs67 as investment in subsidiaries from the consolidated book value. The five-year average trading multiple for SBI is 1.3x P/BV. During the last market peak in January 2008, SBI traded at 1.9x P/BV for the consolidated banking business. SBI's current multiples are lower than what it had traded at during the previous peak. The multiple is higher than the five-year trading range. Not only SBI, but the entire Public

Sector Unit (PSU) banking index has rerated over the past five years as they regained market share from private banks, reduced the duration of their bond portfolios and met stricter capital norms with dilutions lower than private banks. Apart from these drivers, SBI also performed well in terms of increasing market share in retail loans, with an aggressive push on housing loans and improving its fee income substantially.

Exhibit 16. SBI standalone and consolidated – Key parameters

(INRmn)	FY08	FY09	FY10	FY11F	FY12F
Net profit - standalone	67,291	91,212	91,661	117,001	142,951
Net profit - associate banks	22,226	28,606	32,562	30,053	37,905
Net profit consolidated					
Less dividend received from subsidiaries	3,419	3,772	3,675	6,194	6,689
Net profit consolidated	86,098	116,046	120,548	140,861	174,167
EPS standalone	107	144	144	184	225
EPS - associate banks	35	45	51	47	60
EPS - consolidated	136	183	190	222	274
BVPS standalone	776	913	1,039	1,189	1,381
BVPS associate banks	183	228	280	330	386
Consolidated BVPS	959	1,141	1,319	1,519	1,767
Less investment in subsidiaries	60	57	68	74	82
Consolidated BVPS ex subsidiary investments	899	1,084	1,251	1,445	1,685
		2,175	2		
Gross NPLs - standalone	128,373	157,140	195,349	241,700	270,989
Gross NPLs - associate banks		26,999	39,975		
Gross NPLs - consolidated		184,139	235,324		
Net NPLs - standalone	74,243	96,774	108,702	109,692	93,834
Net NPLs - associate banks		11,913	19,611		
Net NPLs - consolidated		108,687	128,313		
Total assets - standalone	7,215,263	9,644,321	10,534,137	12,640,768	14,875,363
Total assets - associate banks	2,682,887	3,156,585	3,590,945	4,074,858	4,662,788
Total assets - consolidated	9,898,150	12,800,906	14,125,082	16,715,626	19,538,151
Loans - standalone	4,167,682	5,425,032	6,319,142	7,582,970	8,913,480
Loans - associate banks	1,647,128	1,971,031	2,262,841	2,599,594	2,989,533
Loans - consolidated	5,814,810	7,396,063	8,581,982	10,182,564	11,903,013
Shareholders' funds - standalone	490,327	579,477	659,492	755,002	876,512
Shareholders' funds - associate banks	115,282	144,739	177,764	209,518	245,074
Shareholders' funds - consolidated	605,609	724,216	837,256	964,520	1,121,586
RoA - standalone	1	1.1	0.9	1	1
RoA - associate banks	0.8	0.8	0.8	0.8	0.9
Consolidated RoA	1	1	0.9	0.9	1
RoE - standalone	16.8	17.1	14.8	16.5	17.5
RoE - associate banks	20.1	22	20.2	15.5	16.7
RoE - consolidated	16.8	17.5	15.4	15.6	16.7
P/E - standalone	30	22	22	17	14
P/E - consolidated	23	17	17	14	11
P/BV - standalone	4	3	3	3	2
P/BV - consolidated	3	3	2	2	2

Source: Company data, Nomura estimates

The following table highlights our FY12F pre- and post-dilution earnings estimates for SBI.

Exhibit 17. Pre- and Post-dilution

FY12F	Pre dilution	Post dilution
BVPS	1,381	1,542
EPS	225	206
Net profit	142,951	147,315
No of shares	634.9	714.9
RoE,%	17.5	15.9
RoA, %	1.0	1.1

Source: Nomura estimates

Why should SBI trade at the same multiple pre- and post-dilution: With a dilution of returns post equity issuances, investors usually like to lower their target multiples for stocks. There are examples of private banks where, post equity issuance, returns have taken a very long time to rise to the pre-dilution levels due to a slowdown in loan growth. ICICI Bank has not been able to fully leverage the funds raised in 2007. We believe this should not be a problem with SBI. After the March 2008 rights offering by SBI wherein its equity was diluted by 20%, SBI's RoE, one-year following the issue, was a healthy 17% against the cost of equity of 12%. We believe that given SBI's market leadership position across retail segments, a strong semi-urban/rural branch network and the strongest corporate relationships among banks, improving leverage post the issue will not be a concern. We expect a RoE of 18% in FY12F compared with 15% in FY10.

Financial statements

Profit and Loss (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Interest income	489,503	637,884	709,939	844,920	991,982
Interest expense	(319,291)	(429,153)	(473,225)	(534,413)	(626,323)
Net interest income	**170,212**	**208,731**	**236,714**	**310,507**	**365,659**
Net fees and commissions	59,143	76,172	96,409	117,618	141,142
Trading related profits	16,498	25,673	21,168	15,000	10,000
Other operating revenue	11,308	25,063	32,105	31,446	27,784
Non-interest income	**86,949**	**126,908**	**149,682**	**164,064**	**178,926**
Operating income	**257,162**	**335,639**	**386,396**	**474,571**	**544,585**
Depreciation					
Amortisation					
Operating expenses	(126,086)	(156,487)	(203,187)	(218,048)	(242,029)
Employee share expense	-	-	-	-	-
Op. profit before provisions	131,076	179,152	183,209	256,523	302,556
Provisions for bad debt	(20,009)	(24,750)	(51,478)	(73,361)	(73,148)
Other provision charges	**(4,490)**	**(2,045)**	**7,530**	**(6,500)**	**(5,000)**
Operating profit	106,576	152,357	139,261	176,662	224,409
Other non-operating income					
Associates & JCEs					
Pre-tax profit	**106,576**	**152,357**	**139,261**	**176,662**	**224,409**
Income tax	(39,285)	(61,145)	(47,600)	(59,661)	(81,458)
Net profit after tax	**67,291**	**91,212**	**91,661**	**117,001**	**142,951**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**67,291**	**91,212**	**91,661**	**117,001**	**142,951**
Extraordinary items					
Reported NPAT	**67,291**	**91,212**	**91,661**	**117,001**	**142,951**
Dividends	(15,235)	(20,892)	(21,414)	(21,414)	(21,414)
Transfer to reserves	**52,056**	**70,320**	**70,246**	**95,587**	**121,537**
Valuation and ratio analysis					
FD normalised P/E (x)	29.8	22.1	22.0	17.3	14.1
FD normalised P/E at price target (x)	24.3	18.0	17.9	14.1	11.5
Reported P/E (x)	29.8	22.1	22.0	17.3	14.1
Dividend yield (%)	0.7	0.9	0.9	0.9	1.1
Price/book (x)	4.1	3.5	3.1	2.7	2.3
Price/adjusted book (x)	4.1	3.5	3.1	2.7	2.3
Net interest margin (%)	2.82	2.63	2.46	2.80	2.77
Yield on interest earning assets (%)	8.11	8.03	7.37	7.61	7.51
Cost of interest bearing liabilities (%)	5.80	5.97	5.46	5.43	5.43
Net interest spread (%)	2.32	2.05	1.91	2.18	2.08
Non-interest/operating income (%)	33.8	37.8	38.7	34.6	32.9
Cost to income (%)	49.0	46.6	52.6	45.9	44.4
Effective tax rate (%)	36.9	40.1	34.2	33.8	36.3
Dividend payout (%)	22.6	22.9	23.4	18.3	15.0
ROE (%)	16.8	17.1	14.8	16.5	17.5
ROA (%)	1.04	1.08	0.91	1.01	1.04
Operating ROE (%)	26.5	28.5	22.5	25.0	27.5
Operating ROA (%)	1.65	1.81	1.38	1.52	1.63
Growth (%)					
Net interest income	20.0	22.6	13.4	31.2	17.8
Non-interest income	28.5	46.0	17.9	9.6	9.1
Non-interest expenses	6.6	24.1	29.8	7.3	11.0
Pre-provision earnings	43.6	36.7	2.3	40.0	17.9
Net profit	83.5	35.5	0.5	27.6	22.2
Normalised EPS	53.0	34.8	0.5	27.6	22.2
Normalised FDEPS	53.0	34.8	0.5	27.6	22.2

Source: Nomura estimates

Growth in NII seen at 31.2% for FY11F and 17.8% for FY12F, growth in operating profit seen at 40% for FY11F and 18% for FY12F

Balance Sheet (Rsmn)					
As at 31 Mar	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash and equivalents	32,203	42,955	68,410	56,208	66,325
Inter-bank lending	57,150	265,987	290,134	337,246	397,951
Deposits with central bank	483,143	512,507	544,499	619,320	729,151
Total securities					
Other interest earning assets	1,997,180	2,982,129	2,916,697	3,592,685	4,250,694
Gross loans	4,221,812	5,485,398	6,405,789	7,735,258	9,126,126
Less provisions	(54,130)	(60,366)	(86,647)	(152,288)	(212,646)
Net loans	**4,167,682**	**5,425,032**	**6,319,142**	**7,582,970**	**8,913,480**
Long-term investments					
Fixed assets	33,735	38,378	44,129	48,542	53,396
Goodwill					
Other intangible assets					
Other non IEAs	444,170	377,333	351,128	403,797	464,366
Total assets	**7,215,263**	**9,644,321**	**10,534,137**	**12,640,768**	**14,875,363**
Customer deposits	5,374,039	7,420,731	8,041,162	9,367,954	11,054,186
Bank deposits, CDs, debentures	128,025	36,783	94,706	108,912	125,249
Other interest bearing liabilities	602,142	803,798	935,410	1,137,282	1,289,485
Total interest bearing liabilities	**6,104,207**	**8,261,312**	**9,071,278**	**10,614,148**	**12,468,920**
Non interest bearing liabilities	620,730	803,532	803,367	1,271,618	1,529,931
Total liabilities	**6,724,937**	**9,064,844**	**9,874,645**	**11,885,766**	**13,998,851**
Minority interest					
Common stock	6,315	6,349	6,349	6,349	6,349
Preferred stock					
Retained earnings	484,012	573,128	653,143	748,653	870,163
Proposed dividends					
Other equity					
Shareholders' equity	**490,327**	**579,477**	**659,492**	**755,002**	**876,512**
Total liabilities and equity	**7,215,263**	**9,644,321**	**10,534,137**	**12,640,768**	**14,875,363**
Non-performing assets (Rs)	*128,373*	*157,140*	*195,349*	*241,700*	*270,989*
Balance sheet ratios (%)					
Loans to deposits	78.6	73.9	79.7	82.6	82.6
Equity to assets	6.8	6.0	6.3	6.0	5.9
Asset quality & capital					
NPAs/gross loans (%)	3.0	2.9	3.0	3.1	3.0
Bad debt charge/gross loans (%)	0.47	0.45	0.80	0.95	0.80
Loss reserves/assets (%)	0.75	0.63	0.82	1.20	1.43
Loss reserves/NPAs (%)	42.2	38.4	44.4	63.0	78.5
Tier 1 capital ratio (%)	9.3	9.5	9.3	8.8	8.6
Total capital ratio (%)	14.0	15.1	14.5	13.6	13.1
Growth (%)					
Loan growth	23.5	30.2	16.5	20.0	17.5
Interest earning assets	25.1	37.0	9.6	20.5	17.8
Interest bearing liabilities	24.2	35.3	9.8	17.0	17.5
Asset growth	27.4	33.7	9.2	20.0	17.7
Deposit growth	23.4	38.1	8.4	16.5	18.0
Per share					
Reported EPS (Rs)	107	144	144	184	225
Norm EPS (Rs)	107	144	144	184	225
Fully diluted norm EPS (Rs)	107	144	144	184	225
DPS (Rs)	21	29	30	30	34
PPOP PS (Rs)	208	282	289	404	477
BVPS (Rs)	776	913	1,039	1,189	1,381
ABVPS (Rs)	776	913	1,039	1,189	1,381
NTAPS (Rs)	776	913	1,039	1,189	1,381

Source: Nomura estimates

Growth in advances seen at 15% over FY1F and FY12F

ANALYST CERTIFICATIONS

We, Mahrukh Adajania and Sreekanth Akula, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
State Bank of India	SBIN IN	3190.25 INR	28 Sep 2010	Buy	

Previous Ratings

Issuer	Previous Rating	Date of change
State Bank of India	Reduce	03 Sep 2009

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A rating of '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
A rating of '**Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
A rating of '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
A rating of '**RS-Rating Suspended'**, indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

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A rating of '2' or '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

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A **'Strong buy'** recommendation indicates that upside is more than 20%.

A **'Buy'** recommendation indicates that upside is between 10% and 20%.

A **'Neutral'** recommendation indicates that upside or downside is less than 10%.

A **'Reduce'** recommendation indicates that downside is between 10% and 20%.

A **'Sell'** recommendation indicates that downside is more than 20%.

SECTORS

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