State Bank of India (SBI.BO)

Equity

4QFY10 Results: Still Waiting for the Turn…

- **Profits down 32%, and disappointing** — SBI's profits have fallen 32% (well below our 13% growth estimate), are qualitatively a little weak though there are bright spots, and are structurally probably fine – long-term market and balance-sheet positioning seems good. The expectation that SBI would turn the corner on balance sheet and P&L in this quarter has been belied, but SBI seems reasonably positioned for that turn – though we don't see it coming in immediate quarters.
- **P&L pain on costs, provisioning and fees, with gains on margins** — The sharp drop in profits is a mix of higher costs (some one-offs, though most seem structural), P&L provisioning reflecting both asset deterioration and the need to raise coverage, and fees have been slack (though management suggests it's a classification issue). There are gains too; margins are up fairly handsomely and management suggests more gains, and talk of aggressive cost control going forward. Overall though, there is pain, and some of it will last a while.
- **Balance sheet – some deterioration, but probable plateau** — NPL's do go up and so do restructured assets, but it is not dramatic, not concentrated and both the mix and management talk suggests asset quality will probably stay at these levels, rather than deteriorate. It is still early for asset quality to turn, and provisioning levels will remain high, but over time probably more upside than downside.
- **Structurally well positioned, but waiting for the business and environment turn** — SBI appears to have positioned itself – from a market, balance-sheet and investment perspective, fairly well. Its deposit franchise is on a roll (CASA up to 46%), loan book is well balanced (15-18% growth across most lending segments) with a realistic 20-22% growth target. Investments in technology, people and process are done and showing results (though more costs for the moment), and the bulk of the pain in doing so, on P&L and balance sheet, already taken. So, just waiting for the turn. Remain buyers of the stock – preferred play among banks.

Buy/Low Risk	**1L**
Price (14 May 10)	Rs2,222.65
Target price	Rs2,515.00
Expected share price return	13.2%
Expected dividend yield	1.3%
Expected total return	**14.5%**
Market Cap	Rs1,411,122M
	US$31,306M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	67,291	116.24	34.7	19.1	2.9	16.8	1.0
2009A	91,212	144.05	23.9	15.4	2.4	17.1	1.3
2010E	102,387	161.27	12.0	13.8	2.1	16.5	1.3
2011E	110,765	174.47	8.2	12.7	1.9	15.7	1.3
2012E	159,033	250.49	43.6	8.9	1.6	19.5	1.4

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	19.1	15.4	13.8	12.7	8.9
P/E reported (x)	19.1	15.4	13.8	12.7	8.9
P/BV (x)	2.9	2.4	2.1	1.9	1.6
P/Adjusted BV diluted (x)	3.4	2.9	2.6	2.2	1.9
Dividend yield (%)	1.0	1.3	1.3	1.3	1.4
Per Share Data (Rs)					
EPS adjusted	116.24	144.05	161.27	174.47	250.49
EPS reported	116.24	144.05	161.27	174.47	250.49
BVPS	776.48	912.73	1,039.20	1,177.67	1,390.96
Tangible BVPS	776.48	912.73	1,039.20	1,177.67	1,390.96
Adjusted BVPS diluted	658.91	762.28	866.22	1,028.27	1,149.30
DPS	21.50	29.00	29.00	30.00	31.00
Profit & Loss (RsM)					
Net interest income	170,212	208,730	235,988	283,404	334,092
Fees and commissions	66,070	87,965	103,273	120,546	138,140
Other operating Income	27,915	38,943	39,888	31,173	34,186
Total operating income	**264,197**	**335,638**	**379,149**	**435,124**	**506,418**
Total operating expenses	-126,086	-156,486	-189,944	-212,150	-236,991
Oper. profit bef. provisions	**138,111**	**179,152**	**189,204**	**222,974**	**269,427**
Bad debt provisions	-20,009	-24,750	-37,050	-57,023	-45,839
Non-operating/exceptionals	-13,712	-12,596	2,000	0	0
Pre-tax profit	**104,389**	**141,806**	**154,154**	**165,951**	**223,588**
Tax	-37,098	-50,594	-51,767	-55,186	-64,555
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**67,291**	**91,212**	**102,387**	**110,765**	**159,033**
Adjusted earnings	67,291	91,212	102,387	110,765	159,033
Growth Rates (%)					
EPS adjusted	34.7	23.9	12.0	8.2	43.6
Oper. profit bef. prov.	29.8	29.7	5.6	17.8	20.8
Balance Sheet (RsM)					
Total assets	**7,215,263**	**9,644,320**	**10,798,309**	**12,454,366**	**14,506,887**
Avg interest earning assets	6,101,618	8,026,789	9,854,418	11,259,163	13,098,790
Customer loans	4,244,341	5,509,818	6,522,377	7,727,886	9,170,106
Gross NPLs	128,373	155,893	187,340	185,617	229,985
Liab. & shar. funds	**7,215,263**	**9,644,320**	**10,798,309**	**12,454,366**	**14,506,887**
Total customer deposits	5,374,039	7,420,731	8,370,686	9,817,401	11,602,871
Reserve for loan losses	76,659	84,786	103,190	121,192	112,788
Shareholders' equity	**490,327**	**579,477**	**659,770**	**747,679**	**883,094**
Profitability/Solvency Ratios (%)					
ROE adjusted	16.8	17.1	16.5	15.7	19.5
Net interest margin	2.79	2.60	2.39	2.52	2.55
Cost/income ratio	47.7	46.6	50.1	48.8	46.8
Cash cost/average assets	2.0	1.9	1.9	1.8	1.8
NPLs/customer loans	3.0	2.8	2.9	2.4	2.5
Reserve for loan losses/NPLs	59.7	54.4	55.1	65.3	49.0
Bad debt prov./avg. cust. loans	0.5	0.5	0.6	0.8	0.5
Loans/deposit ratio	79.0	74.2	77.9	78.7	79.0
Tier 1 capital ratio	9.1	9.4	8.6	8.3	8.4
Total capital ratio	13.5	14.3	12.7	12.2	11.9

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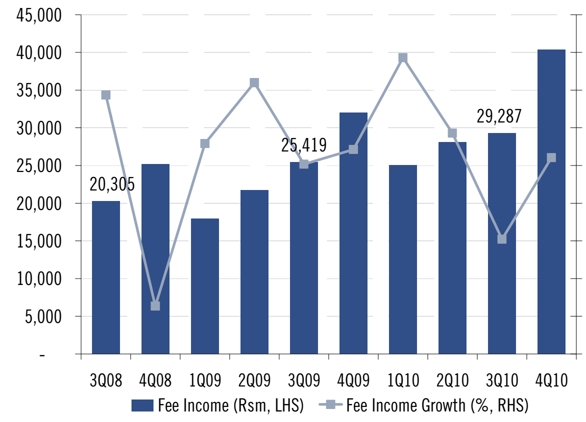
Figure 1. SBI – 4Q10 Financial Highlights (Rupees Million, Percent)

	4Q10	4Q09	YoY %	3Q10	QoQ%	CIRA Comments
Interest Income	179,656	173,424	3.6	177,797	1.0	
Interest Expense	(112,442)	(125,005)	-10.1	(114,634)	-1.9	
Net Interest Income	67,214	48,419	38.8	63,163	6.4	Ahead of expectations, with management guidance for further NIM expansion driven NII
Fee-Based Income	40,358	32,018	26.0	29,287	37.8	Core fee incomes growth is actually disappointing at a modest 3% - possible classification issues, though management guides at a healthy 25% growth
Other Non-Interest Income	4,727	15,164	-68.8	4,370	8.2	Expectedly modest, given a higher rate environment and a big base effect
Non Interest Income	45,085	47,182	-4.4	33,657	34.0	
Operating Income	112,300	95,602	17.5	96,820	16.0	
Operating Expenses	(60,361)	(42,831)	40.9	(50,639)	19.2	Big disappointment once again - primarily employee and distribution investment driven, but predominantly recurring. Management talking aggressive cost control ahead, but the base is fundamentally higher
Pre-Provision Profit	**51,939**	**52,771**	**-1.6**	**46,181**	**12.5**	**Primarily NII and margin driven - low base effect too**
Pre-provisions profit (Ex - trading gains and dividends)	47,212	37,606	11.2	41,811	12.9	
Charges for Bad Debts	(21,868)	(11,953)	-86.4	(4,459)	390.4	Significant increase and a key profit deterrent - impact of deterioration and catch up provisioning. Coverage level remains below regulatory level, so high P&L provisioning will stay for a while
Other Operating Items	(1,626)	(1,824)	NM	(4,107)	-60.4	
Operating Profit	28,445	38,994	-27.1	37,615	-24.4	Undone by costs and provisioning
Pre-Tax Profit	28,445	38,994	-27.1	37,615	-24.4	
Tax	(9,779)	(11,571)	-15.5	(12,825)	-23.8	
Net Profit	**18,666**	**27,423**	**-31.9**	**24,790**	**-24.7**	**40% below our expectations**
EPS	29	43	-31.9	39	-24.7	
DPS	30	29	3.4	0	NM	
Customer Loans	6,414,800	5,485,400	16.9	6,071,540	5.7	Relatively steady growth - broad-based across its lending segments, which is healthy. Management guiding at about 22% growth, only marginally higher than industry growth
Customer Deposits	8,041,160	7,420,730	8.4	7,709,850	4.3	Significant gains - CASA up from 39% to 46%, significant momentum and we believe its distribution build out is set to deliver more for longer
Total Assets	10,534,137	9,241,504	14.0	10,364,303	1.6	
Avg Assets	10,449,220	8,939,212	16.9	10,423,001	0.3	
Non-Performing Loans (NPL)	195,349	155,886	25.3	188,612	3.6	Deterioration continues, albeit at a similar pace as the rest of the year. Probable peaking, but no reversal just yet
Loan Loss Reserves (LLR)	(86,647)	(60,366)	43.5	(75,904)	14.2	Coverage at 60% still short of the 70% mandated by RBI - seeking deferment, but structurally P&L charges will remain high
Shareholders' Funds	659,492	579,477	13.8	652,471	1.1	
Book Value Per Share	1039	913	13.8	1,028	1.1	13% of Tier Cap ad, with 9.5% - Comfortable, though management keen to raise in rights with Govt. contributing - unlikely to happen in the near term
Key Ratios at a Glance (Percent)						
ROAA (annualized)	0.71	1.2	-51	1.0	-24	
ROAE (annualized)	11.3	18.9	-761	15.2	-388	
Net Interest Margin (bps)	296	248	49	282	14	Decent uptick - ahead of expectations and should get past the 300bps in the current year
Fee Inc/Operating Income	35.9	33.5	245	30.2	569	Lack of clarity on numbers, but management suggests all is well, and guides to 25% growth
Other Non-Interest Inc/Op Inc	40.1	49.4	-921	34.8	538	
Op. Cost/ Operating Income	53.7	44.8	895	52.3	145	Problem area, largely structural - revenue momentum the way out, with possible support from cost control
Loan-to-Deposit Ratio (LDR)	79.8	73.9	585	78.8	102	Leveraging up, with a much better liquidity postion on BS than the earlier half of the year
NPL/Loan Ratio	3.0	2.8	20	3.1	-6	Modest improvement, but deterioration at 2% of loans is high and continues - near peak though
LLR/NPL Ratio	44	39	563	40	411	Coverage remains low
LLR/NPL (Incl. Technical W/Offs)	59			56	3	High P&L provisioning pressure ahead, given the need to get to 70%
Restructured Assets	268,470	195,000		NA		Restructured at 5% in line with industry, but have increased -lack of clarity on qoq movement
CASA Ratio	46.67	39.29	7.4	42.94	3.7	

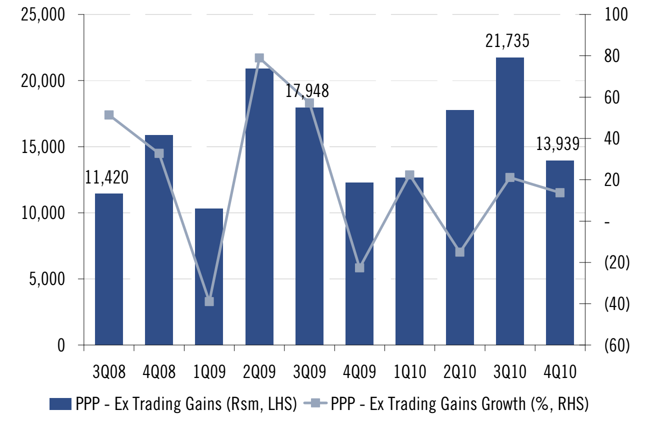
Source: Citi Investment Research and Analysis, Company

Figure 2. Fee Income Growth – Management guides to 25%



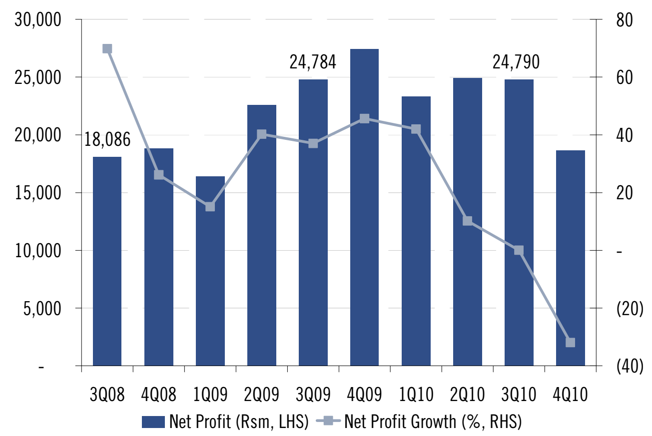
Source: Company Reports

Figure 3. Pre Provisioning Profit – Ex Trading Gains (Rsm, LHS) & Growth (%)



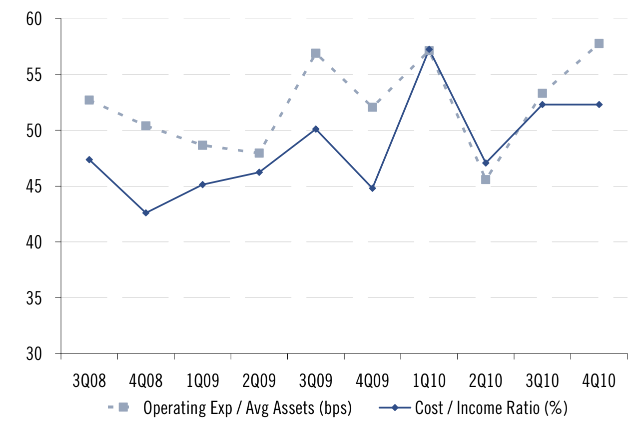
Source: Company Reports

Figure 4. Net Profit (Rsm, LHS) and its Growth (%) - Falling



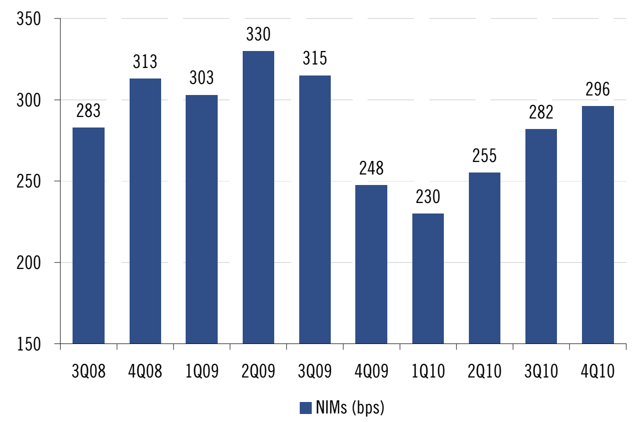
Source: Company Reports

Figure 5. Operating Expenses – Structural pressure point



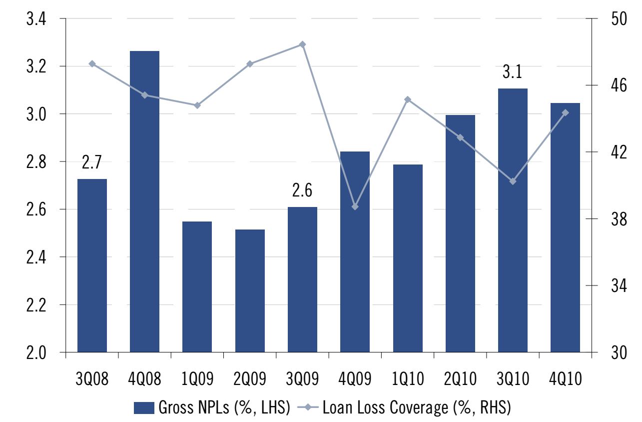
Source: Company Reports

Figure 6. Net Interest Margins (bps) - Back up, and should go higher



Source: Company Reports

Figure 7. Gross NPLs and Coverage Levels – Remains weak and low



Source: Company Reports

State Bank of India

Company description

SBI is India's largest bank with around 18% market share in deposits and loans, over 12,000 branches and more than 90m customers. Together with its seven associate banks (ownership ranging from 75% to 100%), the SBI group has a 25% market share in deposits and loans, and has over 14,000 branches. SBI has the largest overseas presence among Indian banks, with 54 offices in 28 countries. The Government 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 18,000 ATMs spread, the largest in the country. The bank has more than 30m cards outstanding, is networked across over 12,000 offices of the SBI group and is aggressively expanding its technology based offering, across its existing network.

Investment strategy

We rate SBI Buy/Low Risk. 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 has also invested aggressively in its technology platform, Financial Services ventures, its five subsidiary banks, and has aggressively restructured itself to lead and participate in the strong economic and business environment. We expect SBI to generate ROEs of 15-17%, and be more aggressive in leveraging capital that it is in the process of raising.

Valuation

Our target price of Rs2,515 is based on our EVA model, in which we assume a risk-free rate of 8.0%, in line with the market level. Our longer term loan loss assumption is 100bps pa. Our target price for SBI includes a subsidiary valuation of Rs672: Life Insurance at Rs207 per share, associate banks at 1.2x 1Yr Fwd PBV (Rs405), value for SBI's Asset management business (Rs23, 5% of assets) and incorporates capital markets subsidiary at Rs36 based on 10x 1Yr Fwd PE. We also use a sum of parts valuation which values SBI at Rs2,485 per share. In this valuation, we benchmark the parent off a 1.5x 1Yr Fwd P/BV, and factor in Rs672 for its subsidiary businesses. We base our target price on EVA, as we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business.

Risks

While CIRA's quantitative based risk rating system suggests a Medium Risk rating for the stock, we believe a Low Risk rating is more appropriate given the nature of SBI's business, the quality of management, and the direct Government ownership. The downside risks that could impede the stock from reaching our target price include: (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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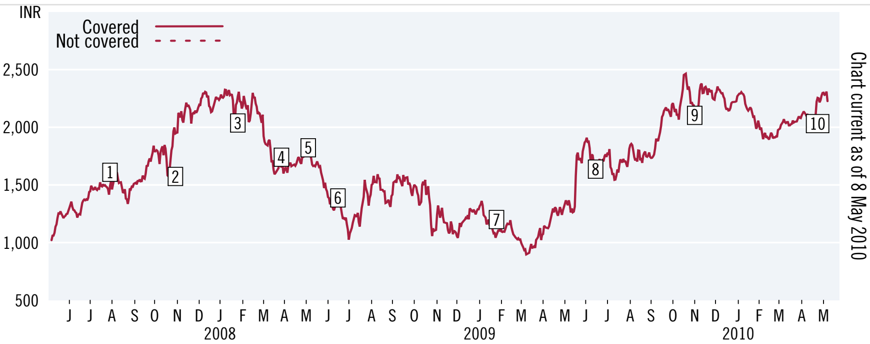
State Bank of India (SBI.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Aditya Narain, CFA



	Date	Rating	Target Price	Closing Price
1	29-Jul-07	1L	*1,721.92	1,415.33
2	30-Oct-07	1L	*2,292.75	1,945.73
3	25-Jan-08	1L	*2,632.42	2,269.17
4	27-Mar-08	1L	*2,790.00	1,650.45
5	5-May-08	1L	*2,370.00	1,779.20
6	15-Jun-08	1L	*1,820.00	1,334.55
7	25-Jan-09	1L	*1,453.00	1,041.75
8	14-Jun-09	1L	*2,122.00	1,637.00
9	2-Nov-09	1L	*2,495.00	2,191.00
10	23-Apr-10	1L	*2,515.00	2,255.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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