

Moody's downgrades SBI; Already known, Priced-in. Buy

Moody's downgrades SBI rating on low tier I & Asset Quality

Today, Moody's Investors Service downgraded SBI's financial strength rating (BFSR), or stand-alone rating, to D+ from C- on lower tier I and asset quality worries. However, the senior foreign currency bond rating remains at Baa2. The report cites SBI's lower tier 1 (at 7.6% as of June '11) as hindering loan growth and providing insufficient comfort in the case of potential higher credit costs as reasons for downgrading. Per Moody's, non-performing assets are likely to rise in the near term due to higher interest rates, which is in sync with our sector view of an emerging credit cycle. The report, however, concedes that SBI's capital ratios will soon be restored through the cap infusion by the government.

Capital & NPL concerns already known, largely priced-in

We believe the two key issues of capital and asset quality are well known and are not 'new'. Moreover, we believe that these issues are largely priced-in. Also, this downgrade will not materially impact SBI's earnings, as 85% of its funding is from domestic sources. Moreover, we believe this downgrade may actually push SBI and the govt to provide more clarity on the timeline for capital raising and expedite the process.

Risk-return stacked in its favor

While SBI is guiding for slippages to remain at elevated levels in 2QFY12, we believe that, at current valuations of 1.2x FY 13 Book (adj. for Subs), the stock is pricing-in most of the negatives. We are building in (our base case) incremental delinquency of +3.2% and weaker loan growth (~14-15%) in FY13. Moreover, under our Stress scenario, we est. delinquency of +3.4% and loan growth of ~13%, despite which we expect SBI's earning to grow by +30/27% (FY12/13) and Tier I at +7.2% in FY12 (+6.8% in FY13). We believe that risk/return is strongly stacked in its favor.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	91,661	82,645	120,046	149,738	189,031
EPS	144.37	130.15	189.05	235.81	297.69
EPS Change (YoY)	0.5%	-9.9%	45.3%	24.7%	26.2%
Dividend / Share	30.00	30.00	45.00	56.00	69.00
GDR EPS (US\$)	6.08	5.71	7.69	9.59	12.11
GDR Dividend / Share (US\$)	1.26	1.32	1.83	2.28	2.81

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	12.4x	13.7x	9.5x	7.6x	6.0x
Dividend Yield	1.68%	1.68%	2.52%	3.13%	3.86%
Pre-exceptional PE	12.38x	13.73x	9.45x	7.58x	6.00x
Price / Book	1.72x	1.75x	1.54x	1.34x	1.15x
RoE / PB	8.60x	7.23x	11.25x	14.11x	17.93x
Price / Pre-Provision Profit	6.19x	4.48x	3.64x	3.16x	2.79x

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Refer to important disclosures on page 6 to 9. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11094074

Equity | India | Banks-Retail
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Stock Data

Price (Common / GDR)	Rs1,787 / US\$77.00
Price Objective	Rs2,700 / US\$120.00
Date Established	14-Aug-2011 / 14-Aug-2011
Investment Opinion	C-1-7 / C-1-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs1,750-Rs3,515
Market Value (mn)	US\$23,088
Market Value (mn)	Rs1,134,870
Shares Outstanding (mn)	635.0 / 317.5
Average Daily Volume	3,585,836
BofAML Ticker / Exchange	SBINF / BSE
BofAML Ticker / Exchange	SBKFF / LIN
Bloomberg / Reuters	SBIN IN / SBI.BO
ROE (2012E)	17.3%
Total Dbt to Cap (Mar-2010A)	NA
Est. 5-Yr EPS / DPS Growth	20.0% / 18.0%
Free Float	20.0%

iQprofileSM State Bank of India

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Net Interest Income	236,714	325,264	396,001	452,098	509,140
Net Fee Income	96,409	115,633	131,821	148,958	169,812
Securities Gains / (Losses)	21,168	9,257	8,794	10,113	10,113
Other Income	32,105	33,356	29,915	31,407	32,974
Total Non-Interest Income	149,682	158,246	170,530	190,478	212,900
Total Operating Income	386,396	483,510	566,531	642,576	722,039
Operating Expenses	(203,187)	(230,154)	(254,497)	(283,792)	(314,762)
Pre-Provision Profit	183,209	253,355	312,034	358,784	407,277
Provisions Expense	(52,279)	(97,687)	(109,411)	(123,177)	(111,680)
Operating Profit	132,479	155,327	203,623	236,607	296,597
Non-Operating Income	8,331	(6,127)	(9,000)	(7,000)	(7,000)
Pre-Tax Income	139,261	149,542	193,623	228,607	288,597
Net Income to Comm S/Hold.	91,661	82,645	120,046	149,738	189,031
Adjusted Net Income (Operating)	91,661	82,645	120,046	149,738	189,031

Key Balance Sheet Data

Total Assets	10,534,137	12,237,362	13,970,267	15,659,319	17,473,219
Average Interest Earning Assets	9,571,987	10,804,352	12,456,570	14,149,055	15,879,420
Weighted Risk Assets	6,693,933	8,365,528	10,207,016	12,557,464	15,882,044
Total Gross Customer Loans	6,319,142	7,567,195	8,777,946	9,962,968	11,357,784
Total Customer Deposits	8,041,162	9,339,328	10,741,162	12,015,552	13,337,069
Tier 1 Capital	659,492	649,860	737,903	847,813	987,772
Tangible Equity	659,492	649,860	737,903	847,813	987,772
Common Shareholders' Equity	659,492	649,860	737,903	847,813	987,772

Key Metrics

Net Interest Margin	2.47%	3.01%	3.18%	3.20%	3.21%
Tier 1 Ratio	9.9%	7.8%	7.2%	6.8%	6.2%
Effective Tax Rate	34.2%	44.7%	38.0%	34.5%	34.5%
Loan / Assets Ratio	60.0%	61.8%	62.8%	63.6%	65.0%
Loan / Deposit Ratio	78.6%	81.0%	81.7%	82.9%	85.2%
Oper Leverage (Inc Growth - Cost Growth)	-14.7%	11.9%	6.6%	1.9%	1.5%
Gearing (Assets / Equity)	16.0x	18.8x	18.9x	18.5x	17.7x
Tangible Common Equity / Assets	6.3%	5.3%	5.3%	5.4%	5.7%
Tangible Common Equity / WRAs	9.9%	7.8%	7.2%	6.8%	6.2%
Revenue Growth	15.1%	25.1%	17.2%	13.4%	12.4%
Operating Expense Growth	29.8%	13.3%	10.6%	11.5%	10.9%
Provisions Expense Growth	92.9%	86.9%	12.0%	12.6%	-9.3%
Operating Revenue / Average Assets	3.8%	4.2%	4.3%	4.3%	4.4%
Operating Expenses / Average Assets	2.0%	2.0%	1.9%	1.9%	1.9%
Pre-Provision ROA	1.8%	2.2%	2.4%	2.4%	2.5%
ROA	0.9%	0.7%	0.9%	1.0%	1.1%
Pre-Provision ROE	29.6%	38.7%	45.0%	45.3%	44.4%
ROE	14.8%	12.6%	17.3%	18.9%	20.6%
RoTE	13.9%	12.7%	16.3%	17.7%	19.1%
RoWRAs	1.4%	1.0%	1.2%	1.2%	1.2%
Dividend Payout Ratio	23.4%	26.0%	26.7%	26.6%	26.0%
Efficiency Ratio (Cost / Income Ratio)	55.6%	48.5%	45.6%	44.9%	44.2%
Total Non-Interest Inc / Operating Inc	39%	33%	30%	30%	29%
Market-Related Revenue / Total Revenues	9.6%	4.9%	3.7%	3.6%	3.3%
Provisioning Burden as % of PPP	28.5%	38.6%	35.1%	34.3%	27.4%
NPLs plus Foreclosed Real Estate / Loans	3.1%	3.3%	3.8%	4.6%	5.1%
Loan Loss Reserves / NPLs	44.8%	55.1%	62.0%	65.9%	67.8%
Loan Loss Reserves / Total Loans	1.4%	1.9%	2.4%	3.2%	3.6%
Provisions Expense / Average Loans	0.9%	1.4%	1.3%	1.3%	1.0%

Other Metrics

Income / Employee	1.93	2.17	2.54	2.87	3.21
(Operating Expenses) / Employee	1.01	1.03	1.14	1.27	1.40
Pre-Provision Profit / Employee	0.915	1.14	1.40	1.60	1.81
Net Profit / Employee	0.458	0.371	0.538	0.669	0.840

Company Description

State Bank of India (SBI), established in 1882, is the largest state-owned bank, having a pan-India presence with a network of over 12,000 branches and over 13,000 ATMs (+18000 group) and balance sheet size of Rs10trn. SBI, along with its seven associate banks (promoted by SBI), enjoys a market share of about 23-24% of the total banking sector. Key beneficiary of the pick-up in overall demand for credit and structural improvement in asset quality. Rising bond yields are a concern.

Investment Thesis

SBI's earnings growth in FY11-13E is to be led by a stronger top line with margin expansion. We estimate FY12 earnings growth of 45%, with RoE to rise from 12.6% in FY11 to 19% by FY13E.

Stock Data

Shares / GDR	2.00
Price to Book Value	1.5x

Price objective basis & risk

SBI (SBINF / SBKFF)

Our 12-month price objective on SBI is Rs2700 (US\$120/GDR). Our PO is based on the average historical PB multiple. Risk-return remains positive, with RoEs (banking biz.) at +20-21% in FY13 (vs +15% in FY11) and the stock trading at 1.2x FY13 BV. Moreover, SBI still is likely to deliver earnings growth of +45/25% for FY12/13, led by the top line. Non-bank biz. adds another Rs265/share (FY13E). Assuming a capital raise in FY12 (US\$1.5bn), RoE still is likely at 18%, with the stock to trade at +1.1x FY13 book. Our PO is benchmarked to the Gordon model theory, where we assume RoE of 20pct and CoE of 14%, and assign a +25% premium to theoretical multiples owing to its large liability franchise and dominant position in the market (+23pct market share at group level). On a PE basis, the stock is trading at 6.4x FY13E if we adjust the share price for the subsidiary value. Risks are a sharp rise in NPLs and a hike in interest rates.

Link to Definitions

Financials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDFE	HDFC IN	Rajeev Varma
	HDFC Bank	XHDFE	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XXMIF	MAX IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

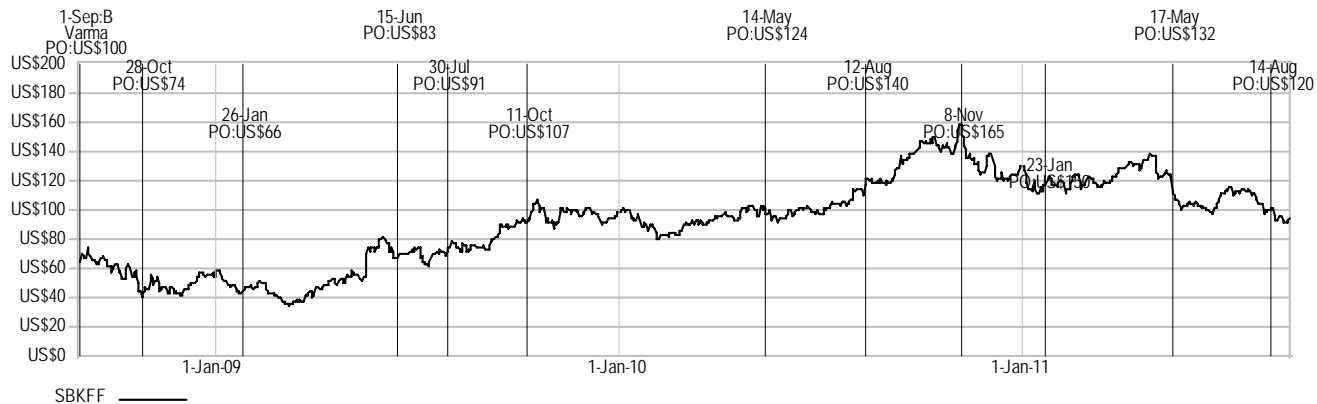
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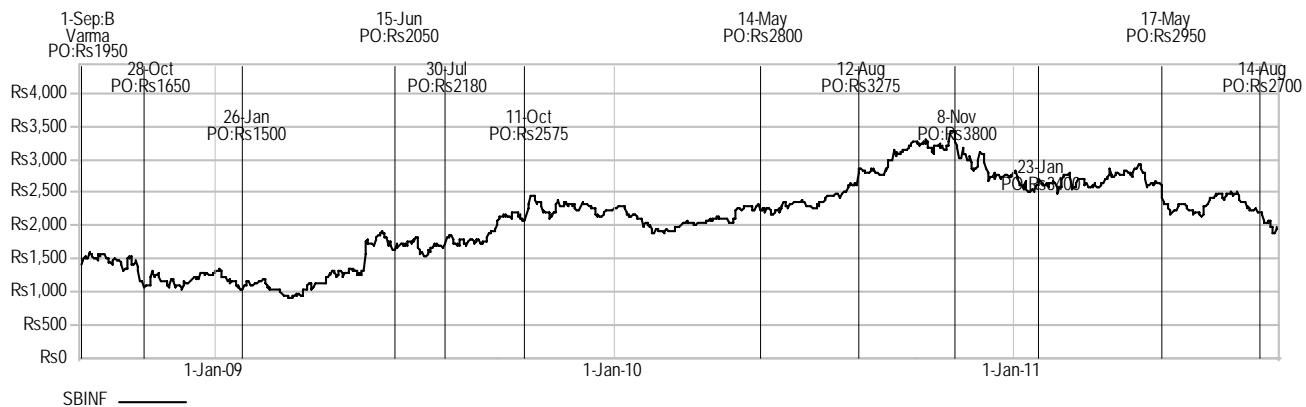
SBKFF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [August 31, 2011] or such later date as indicated.

SBINF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

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Investment Rating Distribution: Banks Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	48.05%	Buy	63	63.00%
Neutral	76	29.69%	Neutral	41	65.08%
Sell	57	22.27%	Sell	27	49.09%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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