

Equities

10 November 2011 | 11 pages

State Bank of India (SBI.BO)

2Q12 Results: Asset Quality Concerns Overshadow Headline Beat

- 2Q12 profits up 12% yoy; 10% ahead of our estimates** — SBI's 2Q12 profits were better than expected and driven by a healthy NIM improvement (+18bps qoq). Pre-provisioning profits (ex-trading gains) were up a healthy 25% yoy, but was overshadowed by a sharp asset quality deterioration – NPLs increased 22% qoq on higher incremental slippages (4.3% annualized) and coverage levels declined further.
- Higher asset quality deterioration however, prompts earnings, target price cut** — SBI's exposures to power (4% of loans) and to state power distribution companies (0.2% of loans) remain low. However, its higher mid-corporate/SME exposures increase its macro leverage, could keep slippages high near term. We reduce earnings 6-7% over FY12-14E on higher credit costs, lower fees and also reduce our EVA based target price to Rs2250 (on revised earnings, higher risk-free rate of 8.5%). SBI is our preferred pick among PSU banks – its higher macro leverage is a key positive in a beneficial macro environment, but also raise risks of elevated slippages near term.
- P&L: Healthy NIM uptick, modest otherwise** — SBI's NIMs increased to 379bps – both domestic (407bps) and international (173bps) margins improved smartly, management guides to higher NIMs near term. Other highlights: a) Fee income was down 6% yoy, sluggish even after adjusting for large one-off fees in 2Q11, b) Markdowns on investment portfolio (equity, mutual funds) were higher than expected, c) Operating expenses were largely stable (cost/income ratio up marginally to 46%), likely to remain at current levels, and d) Credit costs remained high (1.6% annualized).
- Slower growth, stable deposits, focus on capital preservation**— SBI's loan growth slowed down to 17% yoy, well below industry levels as management focus shifts to NIM protection – guides to 16-18% for FY12E. Deposit mix remained stable with CASA ratio at 48% (of which savings 36%), management not contemplating hike in savings deposit rates for now. Capital conservation is another key focus area with government likely to stagger its capital infusion (Rs30-40bn in FY12, balance later) – management's planned efforts likely to save about 30-35bps of Tier1 capital over next 2 quarters.

- Company Update
- Target Price Change
- Estimate Change

Buy	1
Price (09 Nov 11)	Rs1,862.50
Target price	Rs2,250.00
	from Rs2,500.00
Expected share price return	20.8%
Expected dividend yield	1.6%
Expected total return	22.4%
Market Cap	Rs1,182,686M
	US\$23,985M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	91,661	144.37	0.2	12.9	1.8	14.8	1.6
2011A	82,645	130.16	-9.8	14.3	1.8	12.6	1.6
2012E	110,925	174.69	34.2	10.7	1.6	16.0	1.6
2013E	144,407	227.41	30.2	8.2	1.4	18.1	1.7
2014E	175,882	276.98	21.8	6.7	1.2	18.8	1.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	12.9	14.3	10.7	8.2	6.7
P/E reported (x)	12.9	14.3	10.7	8.2	6.7
P/BV (x)	1.8	1.8	1.6	1.4	1.2
P/Adjusted BV diluted (x)	2.1	2.2	1.8	1.5	1.2
Dividend yield (%)	1.6	1.6	1.6	1.7	1.8
Per Share Data (Rs)					
EPS adjusted	144.37	130.16	174.69	227.41	276.98
EPS reported	144.37	130.16	174.69	227.41	276.98
BVPS	1,038.76	1,023.40	1,162.09	1,351.10	1,588.48
Tangible BVPS	1,038.76	1,023.40	1,162.09	1,351.10	1,588.48
Adjusted BVPS diluted	867.55	828.96	1,025.35	1,267.54	1,534.25
DPS	30.00	30.00	30.00	32.00	33.00
Profit & Loss (RsM)					
Net interest income	236,714	325,264	432,431	487,034	552,604
Fees and commissions	112,280	130,273	127,111	145,373	166,293
Other operating Income	37,402	27,973	24,686	26,838	29,221
Total operating income	386,396	483,510	584,227	659,245	748,119
Total operating expenses	-203,187	-230,154	-257,435	-300,032	-339,056
Oper. profit bef. provisions	183,209	253,356	326,793	359,213	409,063
Bad debt provisions	-51,479	-87,921	-119,668	-127,655	-127,260
Non-operating/exceptionals	7,530	-15,893	-22,249	-5,922	-6,988
Pre-tax profit	139,261	149,542	184,875	225,636	274,816
Tax	-47,600	-66,897	-73,950	-81,229	-98,934
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	91,661	82,645	110,925	144,407	175,882
Adjusted earnings	91,661	82,645	110,925	144,407	175,882
Growth Rates (%)					
EPS adjusted	0.2	-9.8	34.2	30.2	21.8
Oper. profit bef. prov.	2.3	38.3	29.0	9.9	13.9
Balance Sheet (RsM)					
Total assets	10,534,137	12,237,337	14,048,974	16,274,315	18,851,829
Avg interest earning assets	9,742,268	11,036,056	12,806,770	14,893,828	17,358,461
Customer loans	6,428,716	7,730,345	9,131,084	10,781,033	12,696,286
Gross NPLs	195,349	253,259	300,707	351,176	406,703
Liab. & shar. funds	10,534,137	12,237,337	14,048,974	16,274,315	18,851,829
Total customer deposits	8,041,162	9,339,328	10,844,122	12,701,684	14,847,037
Reserve for loan losses	109,574	163,151	253,827	345,075	427,475
Shareholders' equity	659,492	649,860	737,926	857,949	1,008,685
Profitability/Solvency Ratios (%)					
ROE adjusted	14.8	12.6	16.0	18.1	18.8
Net interest margin	2.43	2.95	3.38	3.27	3.18
Cost/income ratio	52.6	47.6	44.1	45.5	45.3
Cash cost/average assets	2.0	2.0	2.0	2.0	1.9
NPLs/customer loans	3.0	3.3	3.3	3.3	3.2
Reserve for loan losses/NPLs	56.1	64.4	84.4	98.3	105.1
Bad debt prov./avg. cust. loans	0.9	1.2	1.4	1.3	1.1
Loans/deposit ratio	79.9	82.8	84.2	84.9	85.5
Tier 1 capital ratio	9.5	7.8	7.1	7.0	7.1
Total capital ratio	13.4	12.0	10.8	10.4	10.2

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Figure 1. SBI: 2Q12 Results: Key Highlights (Rupees Million, Percent)

	2Q12	2Q11	YoY %	2Q12	1Q12	QoQ%	CIRA Comments
Interest Income	259,671	198,081	31.1	259,671	241,974	7.3	Loan yields improve to 10.8% for the quarter, up 35bps qoq
Interest Expense	(155,452)	(116,932)	32.9	(155,452)	(144,979)	7.2	
Net Interest Income	104,219	81,149	28.4	104,219	96,995	7.4	Strong NIMs as loan repricing seems to be ahead of deposit costs
Fee-Based Income	33,151	35,248	-5.9	33,151	31,376	5.7	Fee growth declines sharply (partly a base effect on account of large corporate fees in 2Q11), though excluding this also sluggish
Other Non-Interest Income	1,121	4,804	-76.7	1,121	3,966	-71.7	Substantially lower than estimates - partly on lower dividends, partly on equity/MF losses
Non Interest Income	34,272	40,052	-14.4	34,272	35,342	-3.0	Overall, well below expectations
Operating Income	138,492	121,201	14.3	138,492	132,338	4.7	
Operating Expenses	(63,749)	(57,631)	10.6	(63,749)	(59,913)	6.4	Largely stable and in-line with estimates
Pre-Provision Profit	74,743	63,570	17.6	74,743	72,424	3.2	
Pre-provisions profit (Ex - trading gains and dividends)	73,622	58,766	25.3	73,622	68,458	7.5	
Charges for Bad Debts	(30,421)	(21,770)	39.7	(30,421)	(30,699)	-0.9	Credit costs stable qoq at ~1.6%, however, coverage levels have dropped significantly - would expect credit costs to remain high going ahead
Other Operating Items	(3,434)	(4,444)	-22.7	(3,434)	(10,870)	-68.4	
Operating Profit	40,888	37,355	9.5	40,888	30,855	32.5	
Pre-Tax Profit	40,888	37,355	9.5	40,888	30,855	32.5	
Tax	(12,784)	(12,342)	3.6	(12,784)	(15,020)	-14.9	
Net Profit	28,104	25,014	12.4	28,104	15,836	77.5	Strong headline beat, however, asset quality deterioration quite sharp, will be a stock overhang
EPS	44	39	12.4	44	25	77.5	
Customer Loans	8,106,120	6,932,240	16.9	8,106,120	7,881,530	2.8	Loan growth remains slower than industry levels, as management focuses more on net interest margins
Customer Deposits	9,731,711	8,553,450	13.8	9,731,711	9,500,720	2.4	CASA ratio at 47.6% remains largely stable. Management does not expect a near term hike in savings deposit rates
AIEA	10,991,509	9,454,287	16.3	10,991,509	10,724,691	2.5	
Total Assets	12,425,169	11,044,561	12.5	12,425,169	12,482,109	-0.5	
Avg Assets	12,453,639	10,749,172	15.9	12,453,639	12,359,736	0.8	
Non-Performing Loans (NPL)	339,463	232,046	46.3	339,463	277,680	22.2	Sharp increase in NPLs - well ahead of estimates. Incremental slippages also quite high at 4.3%
Loan Loss Reserves (LLR)	(178,258)	(116,034)	53.6	(178,258)	(153,330)	16.3	
Shareholders' Funds	695,271	722,348	-3.7	695,271	665,696	4.4	Tier 1 capital at 7.5%; management expects optimized capital usage to yield around 30-35bps benefits on capital adequacy in next few quarters
Book Value Per Share	1,095	1,138	-3.8	1,095	1,049	4.4	
Key Ratios (%)	2Q12	2Q11	Bps ΔYoY	2Q12	1Q12	Bps Δ QoQ	
ROAA (annualized)	0.9	0.9	-3	0.9	0.5	39	
ROAE (annualized)	16.2	13.9	232	16.2	9.5	665	
Net Interest Margin (bps)	379	343	36	379	362	18	NIM improvement is healthy, one of the few key positives this quarter
Fee Inc/Operating Income	23.9	29.1	-514	23.9	23.7	23	Sharp drop in fee income (partly a base effect), is a cause of concern as it has been a strong earnings driver for the bank
Other Non-Interest Inc/Op Inc	24.7	33.0	-830	24.7	26.7	-196	
Op. Cost/ Operating Income	46.0	47.5	-152	46.0	45.3	76	Largely stable, do not see significant change in this ratio near term
Loan-to-Deposit Ratio (LDR)	83.3	81.0	225	83.3	83.0	34	
NPL/Loan Ratio	4.2	3.3	84	4.2	3.5	66	Significant deterioration in NPLs - a key cause of concern
LLR/NPL Ratio	53	50	251	53	55	-271	
LLR/NPL (Incl. Technical W/Offs)	63.50	60.7	280	63.5	67.25	-375	Coverage ratio has also dropped meaningfully, could continue to weigh on earnings ahead

Source: Citi Investment Research and Analysis, Company Reports

Figure 2. SBI (Standalone) – Earnings Revision Summary

	Net Profit (Rs mn)			EPS (Rs)			Dividend (Rs)	
	Old	New	% Change	Old	New	% Change	Old	New
FY12E	117,864	110,925	-5.9	185.6	174.7	-5.9	30.0	30.0
FY13E	155,892	144,407	-7.4	245.5	227.4	-7.4	32.0	32.0
FY14E	189,052	175,882	-7.0	297.7	277.0	-7.0	33.0	33.0

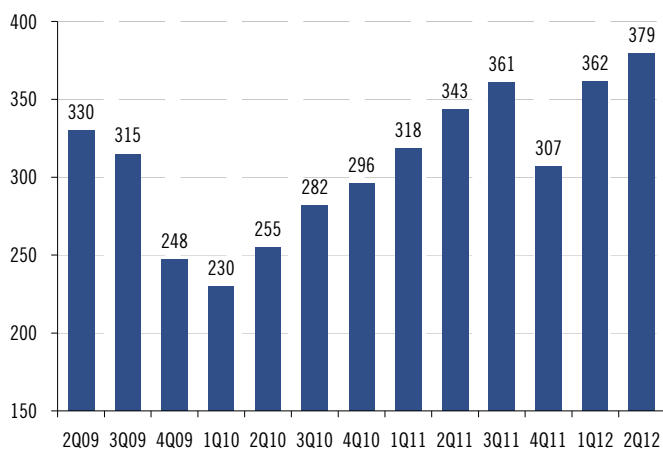
Source: Citi Investment Research and Analysis estimates

Figure 3. SBI (Consolidated) – Earnings Revision Summary

	Net Profit (Rs mn)			EPS (Rs)			Dividend (Rs)	
	Old	New	% Change	Old	New	% Change	Old	New
FY12E	139,985	134,705	-3.8	220.4	212.1	-3.8	30.0	30.0
FY13E	180,808	171,167	-5.3	284.7	269.6	-5.3	32.0	32.0
FY14E	214,100	203,050	-5.2	337.2	319.8	-5.2	33.0	33.0

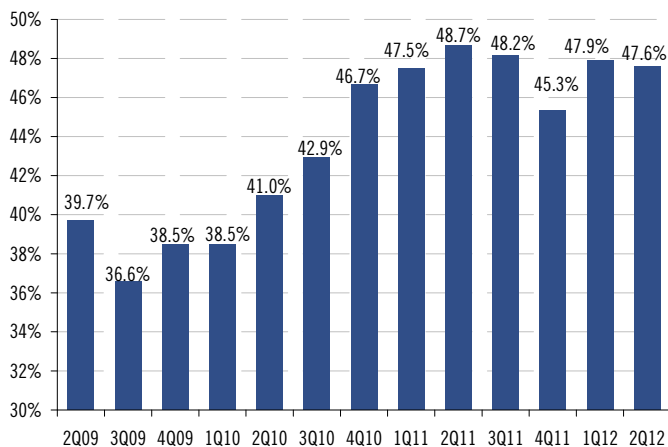
Source: Citi Investment Research and Analysis estimates

Figure 4. SBI: Net Interest Margins (bps)



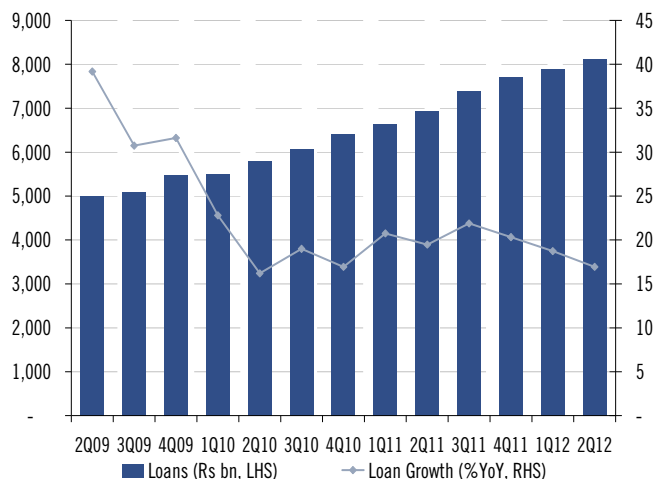
Source: Company Reports

Figure 6. SBI: Low Cost Deposit (CASA) Ratio (%)



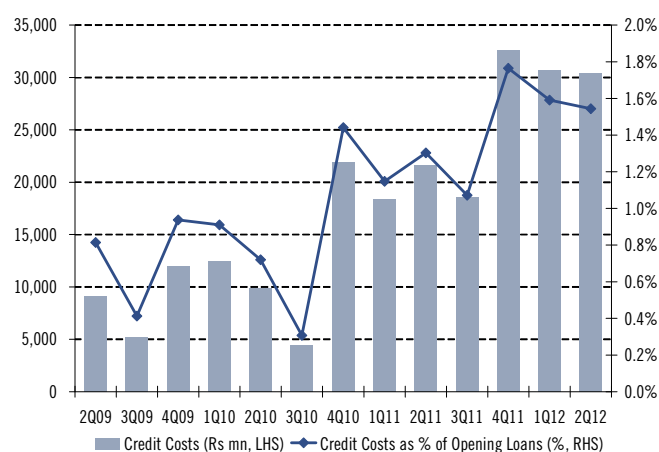
Source: Company Reports

Figure 5. SBI: Loans and Loan Growth (Rupees Billion, %)



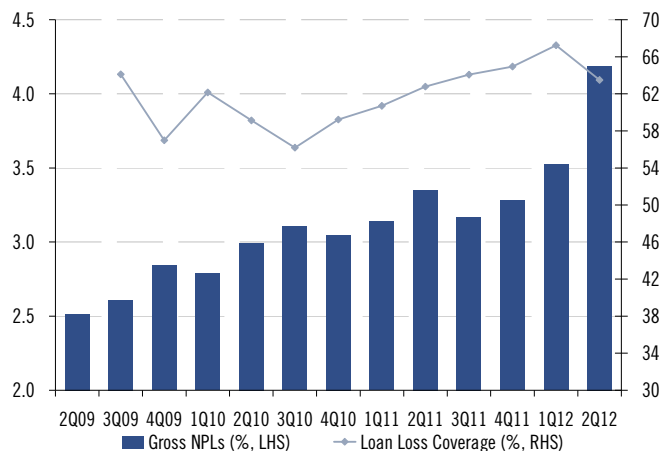
Source: Company Reports

Figure 7. SBI: Credit Costs as % of Opening Loans (Rupees Million, %)



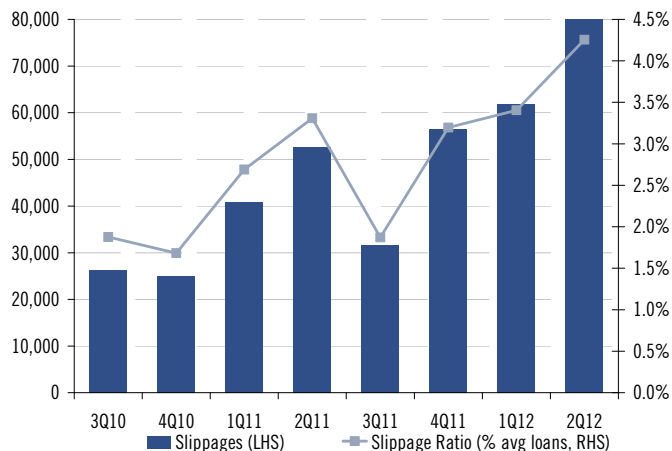
Source: Company Reports

Figure 8. SBI: Gross NPLs and Coverage Levels (%)



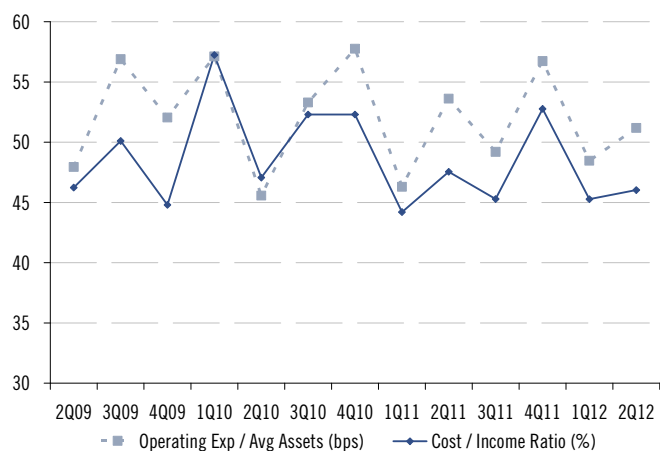
Source: Company Reports

Figure 9. SBI: Slippages (Rupees Million, % YoY)



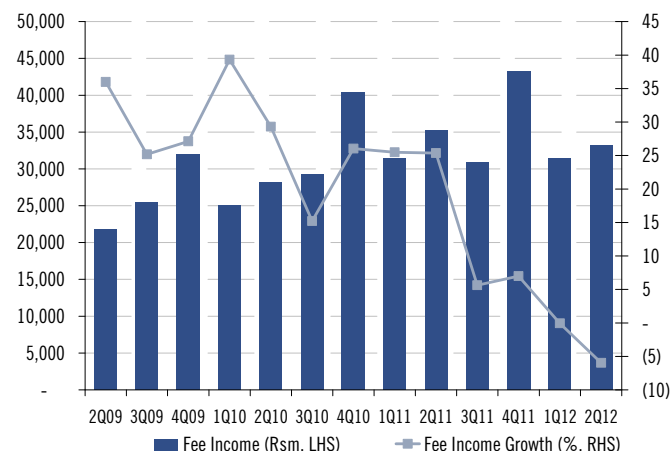
Source: Company Reports

Figure 10. SBI: Cost / Income Ratio and Op. Expenses / Avg. Assets (%)



Source: Company Reports

Figure 11. SBI: Fee Income Growth (Rupees Million, % YoY)



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 13,500 branches and more than 130m customers. Together with its five associate banks (ownership ranging from 75% to 100%), the SBI group has a 25% market share in deposits and loans, and has over 16,000 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 also has a presence in asset management, investment banking and primary dealership. The SBI group has more than 25,000 ATMs, the largest spread in the country, and is aggressively expanding its technology-based offering across its existing network.

Investment strategy

We rate SBI Buy. SBI has faced significant pain recently in terms of operational, accounting and execution slippages. However, we believe its strong deposit franchise, strong market positioning, well diversified asset book and large distribution network are key strengths, which position it well in a rising interest rate and tight liquidity environment. While there are challenges on execution, the new management does seem to be focused on making operational improvements. We believe the SBI will see near-term improvements in key operating parameters, namely net interest margins, operating costs and asset quality slippages. Also, a likely healthy economic and growth environment will also improve its own growth and return profile going ahead. We see value in the stock at current levels.

Valuation

Our target price of Rs2,250 is based on our EVA model, in which we assume a risk-free rate of 8.5%, in line with the market level. Our longer-term loan loss assumption is 100bps pa (in line with the industry). Our target price for SBI includes a subsidiary valuation of Rs515: Life Insurance at Rs98 per share, associate banks at 1.0x 1Yr Fwd PBV (Rs347), value for SBI's Asset management business (Rs20, 4% of assets) and incorporates capital markets subsidiary at Rs49 based on 10x 1Yr Fwd PE. We also use a sum of parts valuation which values SBI at Rs2,240 per share. In this valuation, we benchmark the consolidated banking business off a 1.3x 1Yr Fwd P/BV – slight premium to our benchmark valuation for its peers. We also add Rs168 per share for its non-banking subsidiary businesses as detailed earlier. 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

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 and high interest rates; (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: Manish Chowdhary, CFA
Covered since August 12 2010

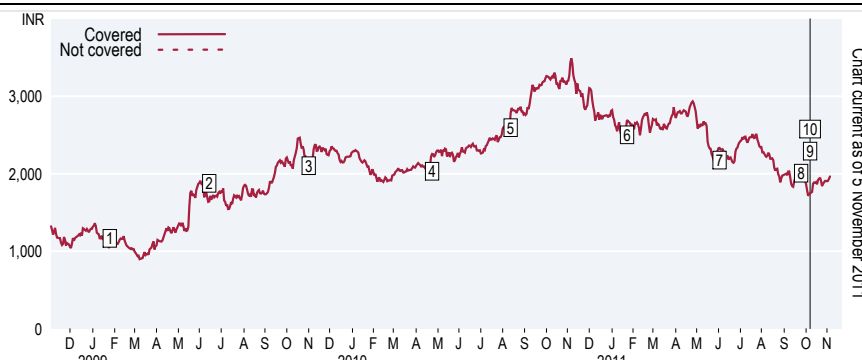


Chart current as of 5 November 2011

	Date	Rating	Target Price	Closing Price
1	25-Jan-09	1L	*1,453.00	1,041.75
2	14-Jun-09	1L	*2,122.00	1,637.00
3	2-Nov-09	1L	*2,495.00	2,191.00
4	23-Apr-10	1L	*2,515.00	2,255.60

	Date	Rating	Target Price	Closing Price
5	12-Aug-10	1L	*3,235.00	2,784.00
6	23-Jan-11	1L	*3,110.00	2,597.95
7	2-Jun-11	1L	*2,650.00	2,332.95
8	26-Sep-11	1L	*2,500.00	1,951.20

	Date	Rating	Target Price	Closing Price
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*1	2,500.00	1,751.85

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

State Bank of India (SBI.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since August 12 2010

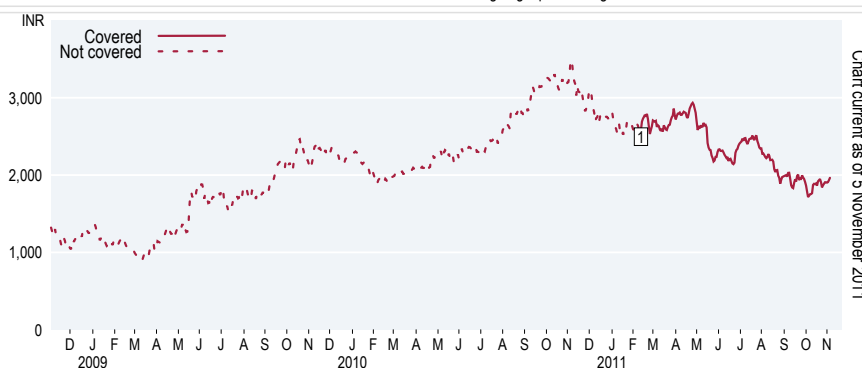


Chart current as of 5 November 2011

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	2,584.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 9 Oct 2011</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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<i>% of companies in each rating category that are investment banking clients</i>	45%	42%	37%	50%	43%	46%

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