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ASIA/PACIFIC

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Stock Rating
Underweight

Industry View
Cautious

State Bank of India

This Tunnel Is a Long One

What's Changed

Price Target	**Rs1,550.00 to Rs1,350.00**
EPS F2012e/F2013e/F2014e	**-2%/-10%/-12%**

NPL problems are firmly entrenched with new NPL formation at 4.7% (annualized, 1 year lag) in F2Q – SME at 8.6% and large corporates at 4.2%. Given slowing growth and elevated rates (yield on domestic loans at ~12.5%), NPL flow will stay high, making it difficult to maintain multiple above book.

Asset quality disappointing, yet again: Credit costs were elevated at 150bp, and coverage dropped to 53% (reducing buffer to handle future bad loans). New NPL flow is large and pace of recoveries is slowing, which will cause gross NPLs ro rise rapidly. The bank also said that restructured loans likely to rise meaningfully. The stock will likely struggle in this backdrop.

NIMs were up, but is it near-term gain for long-term pain: Domestic NIMs were 4.1% in F2Q12, which is similar to HDFC Bank. This is perplexing given that HDBK has a large high-yield consumer (non-mortgage) book where normalized credit costs is almost 150bp.

It seems that SBI has decided to focus solely on NIMs, but this can push some smaller companies into NPL's keeping credit costs elevated into F2013. By then the current crop of restructured loans start turning bad – implying sustained pressure on credit costs. Moreover, as NPLs keep rising. NIMs can fall. We are assuming near-flat earnings into F2013 and are almost 21% below the Street (on parent earnings).

Capital hunt is on: The government will likely put in Rs40bn of capital this year, but this is much lower than required, implying the bank will remain undercapitalized for a number of years. We believe weak earnings, capital and asset quality will cause stock to trade below book over the next year. Support for the stock could come from macro improvement or sharp fall in rates.

Key Ratios and Statistics

Reuters: SBI.BO Bloomberg: SBIN IN
India Financial Services

Price target	Rs1,350.00
Up/downside to price target (%)	(28)
Shr price, close (Nov 9, 2011)	Rs1,862.50
52-Week Range	Rs3,292.00-1,708.55
Mkt cap, curr (mn)	Rs1,182,686
Avg daily trading value (mn)	Rs7,295

Fiscal Year ending	03/11	03/12e	03/13e	03/14e
ModelWare EPS (Rs)	168.28	212.39	218.22	237.23
Prior ModelWare EPS (Rs)	-	215.91	242.97	270.14
Net int inc (Rs mn)	426,464	527,650	563,717	653,842
ModelWare net inc (Rs mn)	106,849	137,663	155,387	186,315
P/E	16.4	8.8	8.5	7.9
P/BV	2.2	1.3	1.2	1.1
Return on avg eqty (%)**	13.2	15.3	13.9	14.2

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
** = Based on consensus methodology
e = Morgan Stanley Research estimates

State Bank of India (Consolidated)

Profit and Loss Statement

Rs Mln (Year end-March)	F2011	F2012E	F2013E	F2014E
Interest Income	1104255	1414317	1689364	1888383
Interest Expense	677791	886667	1125646	1234542
Net Interest Income	**426464**	**527650**	**563717**	**653842**
---Fee Income	141791	144811	159658	182406
---Forex Income	18262	18246	20832	24334
---Capital Gains	12944	6095	9443	12925
---Less:Dividend Income	8277	3932	4325	4757
---Miscellaneous Inc.	9381	8887	10192	12079
Total Non Interest Income	**190655**	**181970**	**204450**	**236501**
Total Operating Income	**617119**	**709620**	**768167**	**890343**
---Employee Exp	186873	201457	244300	295556
---Other Expenses	107501	128077	148695	171439
Total Operating Expenses	294373	329534	392995	466995
Operating Profit	**322746**	**380086**	**375172**	**423348**
---Prov. For Investment Dep.	7533	26362	8400	7500
---Loan Loss Provisions	118493	140556	132157	134302
Total provisions	134348	170059	145057	146602
Profit Before Tax	**188399**	**210027**	**230115**	**276747**
Provision for Tax	83572	75938	78989	94694
Net Profit for the year	**104827**	**134089**	**151126**	**182053**
Less:Minority Interest	3580	2869	3149	4259
Banking Net Profit for SBI Shar	**101246**	**131220**	**147978**	**177794**
Other Subs/Adj.	5603	6443	7409	8521
Reported Consol Profit	**106849**	**137663**	**155387**	**186315**

Balance Sheet Data

Rs Mln (Year end-March)	F2011	F2012E	F2013E	F2014E
Share holders equity	811104	992527	1240174	1382381
Deposits	12458624	14595035	16843148	19724601
Borrowings	916372	1057457	1215111	1419117
Other Liabilities & Prov.	1757904	1959895	2214069	2503161
Total Liabilities	**15962616**	**18627879**	**21538101**	**25058432**
Cash & Balances with RBI	1192338	1276168	1399459	1635570
Balances with Banks	339789	321038	376105	440672
Investments	3842909	4773263	5730931	6579143
Advances	9941536	11571922	13256291	15525589
Fixed Assets	65647	69830	75813	82313
Other Assets	580564	616026	699872	795512
Total Assets	**15962784**	**18628248**	**21538469**	**25058800**
Earning Assets	15330631	17956450	20776843	24195033
Asset Quality				
Annual LLP / Advances (bps)	117	124	103	89
Gross NPL	310873	514926	655852	770865
Net NPL	151375	258485	327374	380795
Reserve Coverage	159498	256440	328478	390071
Gross NPL Ratio	3.1%	4.4%	4.8%	4.8%
Net NPL Ratio	1.5%	2.2%	2.5%	2.5%
Coverage Ratio*	65%	62%	61%	59%

**Coverage Ratio from F2009 onwards includes Technical Write-offs.*

Per Share Data and Valuations

Year end-March	F2011	F2012E	F2013E	F2014E
Per Share Data (Rs)				
EPS	168.3	212.4	218.2	237.2
Book Value	1277.3	1443.4	1579.1	1760.2
DPS	36.6	38.8	40.0	46.6
Valuations				
PE	11.1	8.8	8.5	7.8
Price to Book	1.5	1.3	1.2	1.1
Dividend Yield	2.0%	2.1%	2.1%	2.5%

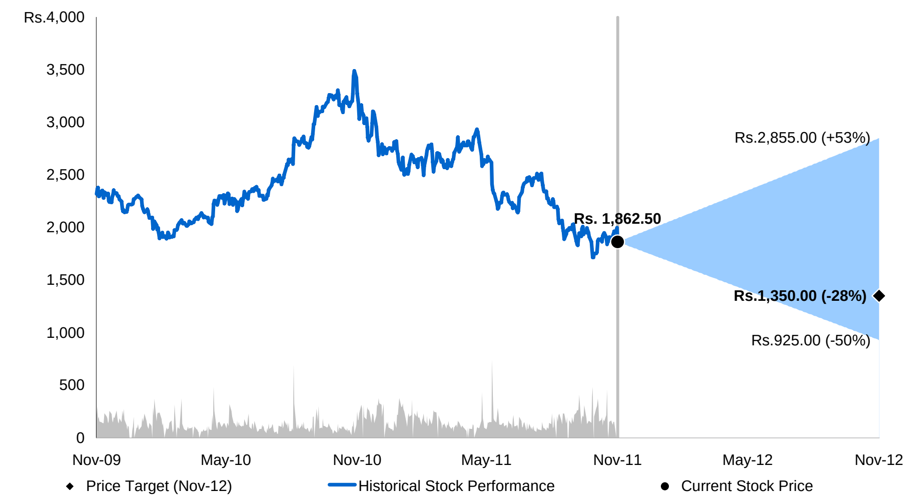
Ratio Analysis

Year end-March	F2011	F2012E	F2013E	F2014E
Spread Analysis				
Average yield on assets	7.8%	8.7%	8.7%	8.4%
Cost of earning assets	4.8%	5.5%	5.8%	5.5%
Net Interest Margin (NIM)	3.0%	3.2%	2.9%	2.9%
Growth Ratios				
Net Interest Income	36.3%	23.7%	6.8%	16.0%
Non Interest Income	5.7%	-4.6%	12.4%	15.7%
Operating expenses	17.5%	11.9%	19.3%	18.8%
Operating Profit	33.0%	17.8%	-1.3%	12.8%
Net Profit	-8.9%	28.8%	12.9%	19.9%
EPS	-8.9%	26.2%	2.7%	8.7%
Deposits	12.4%	17.1%	15.4%	17.1%
Advances	15.9%	16.4%	14.6%	17.1%
Total Assets	13.1%	16.7%	15.6%	16.3%
Profitability Ratios				
Return On Equity	13.2%	15.7%	14.2%	14.2%
Return on Assets	0.7%	0.8%	0.8%	0.8%
Efficiency Ratios				
Cost Income Ratio	47.7%	46.4%	51.2%	52.5%
Expenses/Avg Assets	2.0%	1.9%	2.0%	2.0%
Capital Ratios (Parent only)				
Tier 1 Ratio	7.8%	8.3%	9.0%	8.6%
Tier 2 Ratio	4.2%	4.1%	3.5%	3.0%
Capital Adequacy Ratio	12.0%	12.4%	12.6%	11.6%

Source:Company Data, E=Morgan Stanley Research Estimates

Risk-Reward Snapshot: State Bank of India (SBI.BO, Rs1,862.50, UW, PT Rs1,350)

Risk-Reward View:
Asset-quality Concerns Will Continue to Weigh on Multiples



Price Target Rs1,350		Derived from our probability-weighted residual income model Bull 5%; Base 50%; Bear 45%
Bull Case Rs2,855	2.0x F2012e BVPS	**Interest rates soften sooner than expected:** Loan growth is much stronger than base case. Margins stay strong in F2013, given drop in deposit rates. Asset quality trends are better than expected. Value insurance business at Rs156/share using a new business multiplier of 16x and an NBAP margin of 16%.
Base Case Rs1,580	1.1x F2012e BVPS	**Weak economic growth, rates higher for longer:** Loan book expands 15.5% in F2012-13. Margins remain broadly stable through the rest of the year. Credit costs remain at elevated levels of 124bp in F2012 and 103bp in F2013. Value the insurance business at Rs120/share using a new business multiplier of 14x and an NBAP margin of 14%.
Bear Case Rs925	0.6x F2012e BVPS	**Materially weaker economic growth:** Loan growth and margins are lower than base case. Impaired loan creation is higher than expected, driven by high slippages from SME and corporate capex loans + restructuring in the infrastructure space. Value the insurance business at Rs76/share using a new business multiplier of 10x and an NBAP margin of 10%.

Source: FactSet, Morgan Stanley Research estimates

Investment Thesis

- Asset quality will continue to be under pressure, given peak lending rates and slowing growth.
- Margin progression is strong but is driven by loan yields increasing to new highs.
- Tier I capital ratio is one of the weakest amongst Asian peers, at 7.8% (as of Mar-11).
- Trading at 8.8x F2012e earnings. On adjusted book value, it is trading at 1.3x F2012e. Multiples could be under pressure as revenue growth slows and asset-quality pressures increase.

Key Value Drivers

- Revenues – margin progression, loan growth and fee income progression.
- New impaired loan creation trends.
- Life insurance valuation/market share.

Potential Catalysts

- System-wide loan/deposit growth trends
- Margin progression
- Deposit rate trends in India
- Impaired loan trends

Key Upside Risks

- NPL cycle improves sharply.
- Meaningful decline in interest rates in India.
- Stronger revenue progression supported by better-than-expected NIMs and fees.

Investment Case

Investors have been asking us whether we see any light at the end of the tunnel for SBI; whether NPLs in F4Q11 and F1Q12 were a part of kitchen sinking exercise, given that there was a management change toward the end of F2011. Our view is that this is not the case – a combination of slowing economic growth and higher interest rates is hurting the bank's asset quality. We expect impaired loan formation to stay elevated for a sustained period of time, which will cause the stock to continue its de-rating trend. We like the deposit franchise, but we need better visibility on the macro outlook before becoming more positive on the stock.

F2Q12 earnings: SBI reported PBT of Rs40.9bn (+9% YoY and +33% QoQ) – about 10% lower than our estimate of Rs45.4bn. Reported profit was Rs28.1bn (3% higher than our estimate as the effective tax rate was lower than expected).

The PBT miss was driven by higher-than-expected loan loss provisions – as the new NPL creation picked up to Rs80bn (4.7% of one-year lagged loans, annualized), even higher than the Rs62bn (3.8%) reported in QE Jun-11. NII growth was strong at 9% QoQ and 30% YoY, driven by a 22bp sequential expansion in margins. However, this was offset by lower fee income. As a result, total revenue was broadly in line with estimates.

Exhibit 1
SBI F2Q12: Actual vs. Estimates

Rs Bn	F2Q11	F1Q12	F2Q12e	F2Q12a	Act vs. Est.	%YoY	%QoQ
Reported NII	81.1	97.0	99.9	104.2	4%	28%	7%
Adjusted NII	**79.9**	**95.7**	**99.9**	**104.2**	**4%**	**30%**	**9%**
Total Non Int Inc	**41.3**	**36.7**	**37.9**	**34.3**	**-10%**	**-17%**	**-7%**
--o/w Cap Gains	2.0	1.7	1.5	0.3	-81%	-86%	-83%
--o/w Non-Int Inc ex Cap Gains	39.3	35.0	36.4	34.0	-7%	-13%	-3%
Total Income	**121.2**	**132.3**	**137.8**	**138.5**	**1%**	**14%**	**5%**
Total Expenses	57.6	59.9	66.2	63.7	-4%	11%	6%
Pre Prov. Profit	**63.6**	**72.4**	**71.6**	**74.7**	**4%**	**18%**	**3%**
Total Provisions	26.2	41.6	26.1	33.9	29%	29%	-19%
--o/w Provisions for NPA	21.6	27.8	20.2	29.2	45%	35%	5%
PBT	**37.4**	**30.9**	**45.4**	**40.9**	**-10%**	**9%**	**33%**
Tax	12.3	15.0	18.2	12.8	-30%	4%	-15%
PAT	**25.0**	**15.8**	**27.2**	**28.1**	**3%**	**12%**	**77%**
Core Revenues	**112.5**	**125.3**	**131.3**	**135.0**	**3%**	**20%**	**8%**
Core PPOP	**57.6**	**65.4**	**65.1**	**71.5**	**10%**	**24%**	**9%**

e = Morgan Stanley Research estimates; Source: Company data, Morgan Stanley Research

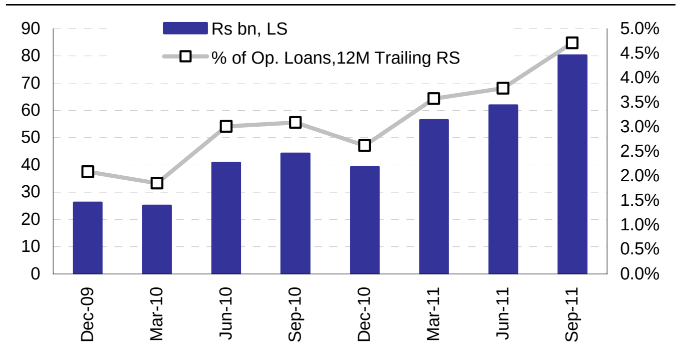
Asset Quality Deteriorated Further

Slowing growth and higher rates caused the sharp spike in NPLs. Moreover, the bank said that it believes Indian banks are facing a sharp increase in restructured loan book. While large corporates will likely be restructured, smaller ones are struggling. For instance, management mentioned that borrowers along the infrastructure and coal supply chains are struggling. The key points in asset quality are:

1) New NPL creation pickup up: SBI's new NPL creation rate picked up Rs80bn (4.7% of one-year lagged loan book, annualized) from the previous quarter's already elevated level of Rs56bn (3.8% of loans).

The worrisome part was that almost all domestic loan segments – corporate, SME, agri and retail – saw an increase in NPL formation rates this quarter (see Exhibit 3 and 5).

Exhibit 2
New NPL Creation Increased Further

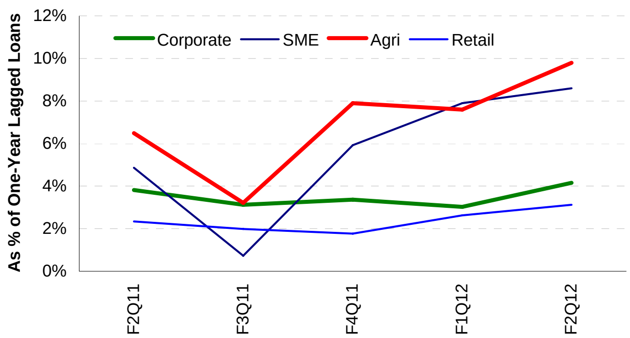


Source: Company data, Morgan Stanley Research

The sharpest increase was in the corporate side, where new NPL creation rate moved up to 4.2% from 3%. SME new NPL creation stayed very elevated at 8.6% versus 7.9% the previous quarter. The key sectors driving the pickup in these two segments are highlighted in Exhibit 4.

Exhibit 3

What Is Driving the Increase in Slippage Rate?



Source: Company data, Morgan Stanley Research

Exhibit 4

Key Sectors Driving Slippage in Large and Mid-Corporate Segment

	Rs mn		% Share	
	F1Q12	F2Q12	F1Q12	F2Q12
Iron & Steel + Metals and Mining	4120	4770	11%	10%
Agro Based	1450	12680	4%	27%
Govt Sponsored	1070	2740	3%	6%
Textiles	4110	2890	11%	6%
Engineering	890	890	2%	2%
Gems & Jewellery	1170	2190	3%	5%
Infrastructure	6500	620	18%	1%
Hospitality	910	2380	2%	5%
Paper/ Plastics etc	790	1720	2%	4%
Trading & Retail	4630	1200	13%	3%
Education	630	650	2%	1%
IT	70	120	0%	0%
Miscellaneous	10430	14120	28%	30%
Total	36770	46970	100%	100%

Source: Company data, Morgan Stanley Research

Exhibit 5

Breakdown of New NPL Creation

	F2Q11	F3Q11	F4Q11	F1Q12	F2Q12	QoQ	YOY
Rs mn							
Corporate	19030	16320	18520	17160	24540	43%	29%
SME	11770	1870	14430	19610	22440	14%	91%
Agri	9570	4910	12590	14420	20080	39%	110%
Retail	7140	6380	5940	9200	11660	27%	63%
International	5150	2050	4970	1410	1430	1%	-72%
Total	**52660**	**31530**	**56450**	**61800**	**80150**	**30%**	**52%**
As % of Total Slippages							
Corporate	36%	52%	33%	28%	31%	2.9%	-5.5%
SME	22%	6%	26%	32%	28%	-3.7%	5.6%
Agri	18%	16%	22%	23%	25%	1.7%	6.9%
Retail	14%	20%	11%	15%	15%	-0.3%	1.0%
International	10%	7%	9%	2%	2%	-0.5%	-8.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**0.0%**	**0.0%**

Source: Company data, Morgan Stanley Research

Management indicated that there were two large accounts in the agro-based segment (Rs12.7bn of slippages this quarter), one of which was already restructured and that slipped into NPLs this quarter.

Slippages from restructured loans into NPLs moved up sharply to Rs17.6bn from Rs8.4bn in the previous quarter. Cumulative slippage seen from the restructured loan book now stands at 22%. We expect this trend to continue, and would not be surprised if the slippage were to go beyond 30% in the current macro environment.

2) Restructuring done this quarter was low: The good news on asset quality was that new restructuring done during that quarter was Rs5.1bn (0.3% of loans) in F2Q vs. Rs5.6bn in the previous quarter. Hence, the total impaired (NPLs + restructured loans) loan creation rate was 5.0%. Stock of impaired loans moved up 30bp QoQ to 7.8% of loan book.

Exhibit 6
Impaired Loans Ratio

		Sep-10		Jun-11		Sep-11	
		Rs bn	As % of loans	Rs bn	As % of loans	Rs bn	As % of loans
A	GNPLs	232	3.4%	278	3.6%	339	4.3%
B	Restructured Loans (under RBI special scheme)	168	2.5%	184	2.4%	184	2.3%
C	--- Slipped into NPLs	24	0.4%	37	0.5%	44	0.6%
D	--- Balance	144	2.1%	147	1.9%	140	1.8%
E	Other loans restructured (outside RBI scheme)	139	2.0%	165	2.1%	170	2.2%
F	--- Slipped into NPLs	13	0.2%	23	0.3%	34	0.4%
G	--- Balance	125	1.8%	143	1.8%	137	1.7%
H	Impaired Loans (H = A + D + G)	501	7.4%	567	7.4%	616	7.8%
I	Total Loans	6807		7709		7906	

Source: Company data, Morgan Stanley Research

3) Recovery and up-gradation trends also weakened: Recovery and upgrades moved lower to 1% (of one-year lagged loans, annualized) from the 1.5-1.9% run-rate that we have been seeing in the past few quarters. SBI management indicated that the weaker macro backdrop has made the conditions more challenging for recovery / upgrades.

Exhibit 7
Flow of NPLs

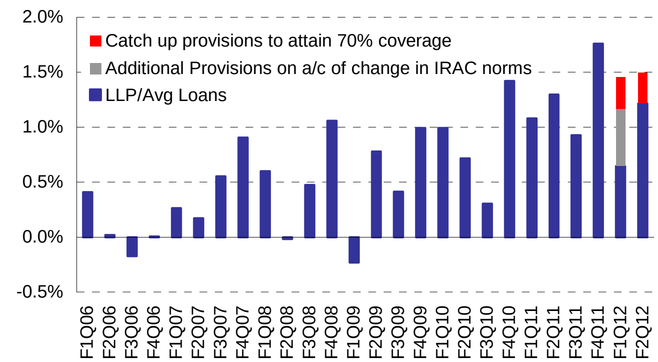
% of opening loans (12M Trailing)	F2Q11	F3Q11	F4Q11	F1Q12	F2Q12
Op. NPAs	**3.6%**	**3.9%**	**3.7%**	**3.9%**	**4.1%**
New NPL Creation	**3.7%**	**2.6%**	**3.6%**	**3.8%**	**4.7%**
Organic	3.1%	2.6%	3.6%	3.8%	4.7%
--- Restructured	0.5%	0.3%	0.1%	0.3%	0.3%
--- Others	2.6%	2.3%	3.5%	3.4%	4.4%
-- SB Indore	0.6%	0.0%	0.0%	0.0%	0.0%
Upgrade / recovery	**-1.5%**	**-1.5%**	**-1.7%**	**-1.9%**	**-1.0%**
Write-off	-0.6%	-1.0%	-0.7%	-0.4%	0.0%
Closing NPAs	**4.1%**	**3.9%**	**4.0%**	**4.3%**	**5.0%**

*Annualized Source: Company Data, Morgan Stanley Research

4) NPL coverage ratios deteriorated sequentially: Total credit costs this quarter were Rs29.2bn (150bp of loans, annualized). Out of this, Rs5.5bn (28bp) were catch-up provisions required to meet the 70% coverage requirement (on Sep-10 NPL base). Hence, underlying credit costs were Rs23.7bn (121bp).

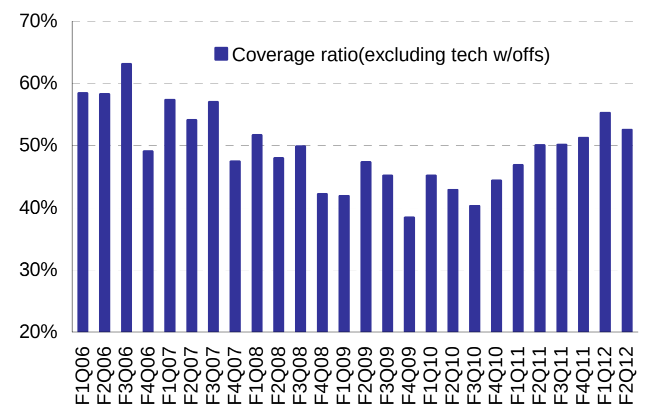
After showing multiple quarters of improvement (albeit from a low base), the coverage deteriorated this quarter. Including technical write-offs, the ratio dropped to 52.5% from 55.2% while excluding technical write-offs it dropped to 63.5% from 67.3%.

Exhibit 8
LLP / Average Loans Were Elevated



Source: Company data, Morgan Stanley Research

Exhibit 9
Coverage Ratio Moved Lower



Source: Company data, Morgan Stanley Research

5) Asset quality trends in subsidiaries was also weak: SBI's banking subsidiaries also saw stress in terms of asset quality. Their combined GNPLs were up 45% QoQ and 63% YoY. The GNPL ratio moved up to 4.6% from 3.7% sequentially and the coverage ratio (excluding technical write-offs) dropped to 44% from 54%. SBI management indicated that part of the deterioration was due to transition to computer-based system of NPL recognition (similar to other SOE banks).

Exhibit 10

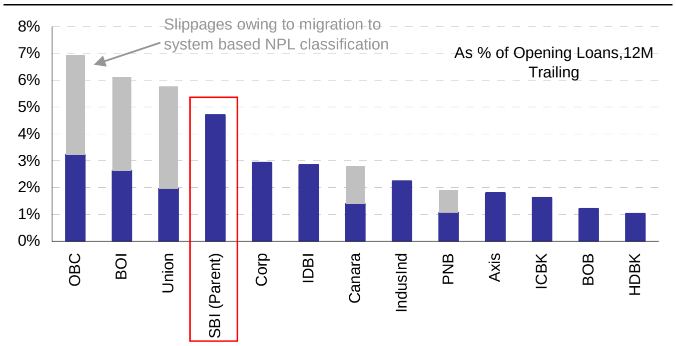
SBI Subs GNPL Ratio Increased 110bp Sequentially to 4.6%

	F2Q11	F1Q12	F2Q12	% QoQ	% YoY
GNPLs					
SBBJ	9433	10621	16520	56%	75%
SBT	8348	10374	13779	33%	65%
SBM	9697	9666	13344	38%	38%
SBP	15137	14050	18652	33%	23%
SBH	8372	12809	20953	64%	150%
Total	**50987**	**57520**	**83247**	**45%**	**63%**
Coverage					
SBBJ	52%	53%	34%	-19%	-18%
SBT	42%	46%	38%	-8%	-4%
SBM	53%	51%	52%	1%	-1%
SBP	59%	65%	56%	-9%	-3%
SBH	58%	51%	39%	-11%	-19%
Total	**54%**	**54%**	**44%**	**-10%**	**-10%**

Source: Company data, Morgan Stanley Research

Exhibit 11

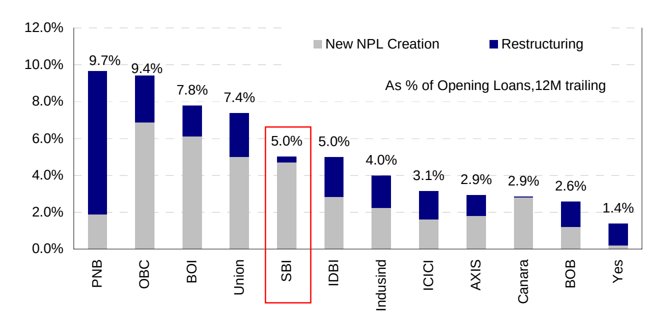
SBI's New NPL Creation Rate at the Higher End When Compared to Other Banks



Source: Company data, Morgan Stanley Research

Exhibit 12

Indian Banks: New Impaired Loan Creation



Source: Company data, Morgan Stanley Research

Outside of loan loss provisions, SBI also had a MTM provision of Rs4.6bn on its investment book (down from Rs10.5bn in previous quarter). About Rs4.8bn of the same was due to lower values of the equity investments in other SOE IPOs in the past year. SBI also had Rs1.5bn of provisions on account of a CDS transaction on a FCCB bond that it had underwritten in 2008. This was offset by a write-back of Rs1.7bn of provision in its domestic bond book.

Exhibit 13

Split of Total Provisions – Large Investment Depreciation Provision in F2Q

Rs Mn	F2Q11	F1Q12	F2Q12	YoY	QoQ
Total Provisions	26215	41569	33855	29%	-19%
---Loan Loss Provisions	21625	27817	29212	35%	5%
---Standard Assets Provision	146	2883	1209	730%	-58%
---Investment Depreciation	4318	10480	4583	6%	-56%
---Other Provisions	126	390	-1149	NA	NA

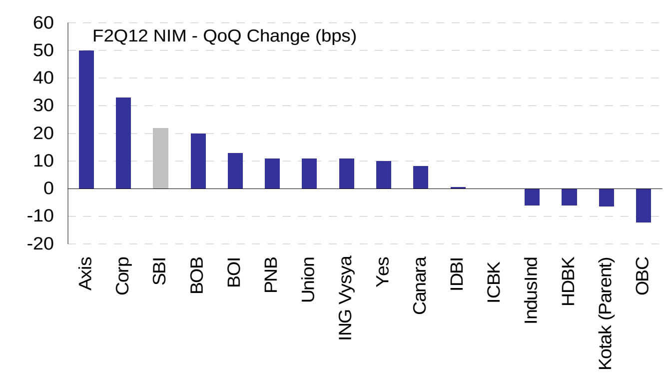
Source: Company data, Morgan Stanley Research

Margin Progression Was Strong; Aided by Higher Loan Yields

NIMs (adjusted for interest on IT refunds) expanded 22bp QoQ from the previous quarter's adjusted level of 3.57% to 3.79% (+36bp YoY). Domestic NIMs expanded 23bp QoQ to 4.1%. International NIMs were broadly stable sequentially at 1.73%.

Exhibit 14

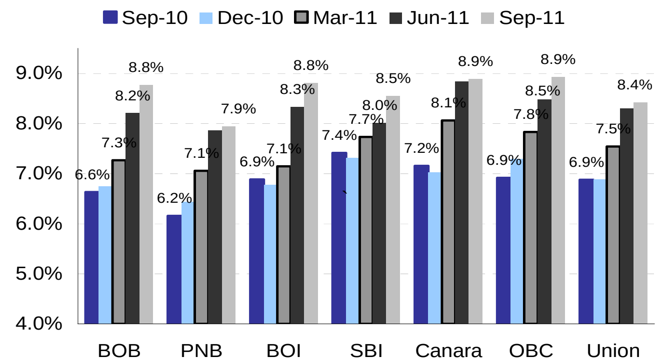
SBI's Underlying NIMs Expanded 22bp QoQ – One of the Highest Among Peers



Source: Company data, Morgan Stanley Research

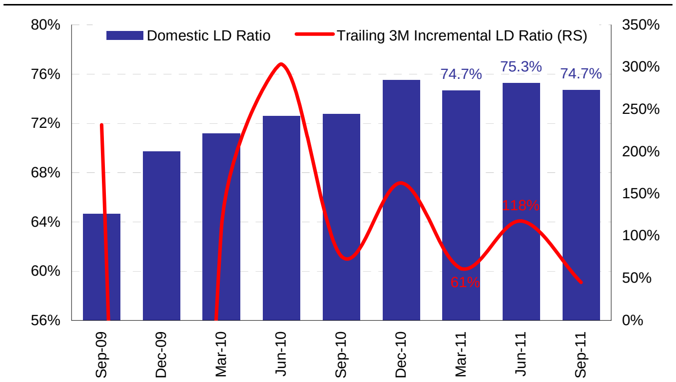
What explains the margin expansion this quarter? The key driver of SBI's and other banks' margin expansion has been the increase in loan yields. On our computations, SBI's global loan yields (domestic + international) expanded 70bp QoQ to 11.1%. This helped more than offset the 34bp QoQ increase in global deposit cost (owing to a 50bp QoQ increase in term

Exhibit 15
Portfolio Term Deposit Repricing Upwards



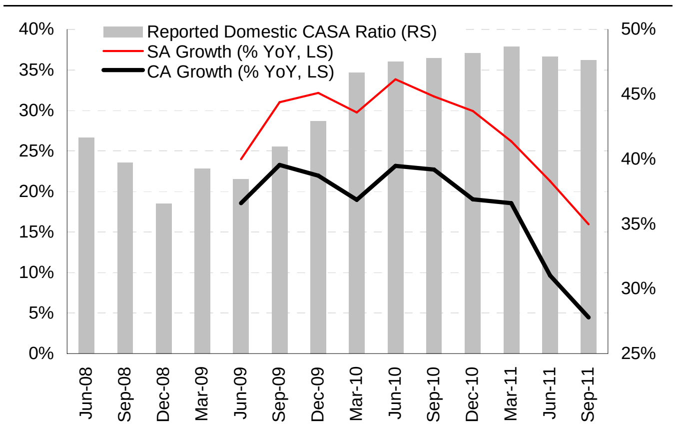
Source: Company data, Morgan Stanley Research

Exhibit 16
Domestic LD Ratio still Elevated



Source: Company data, Morgan Stanley Research

Exhibit 17
CASA Growth Moderating;
CASA Ratio -27bp QoQ; -17bp YoY at 47.6%



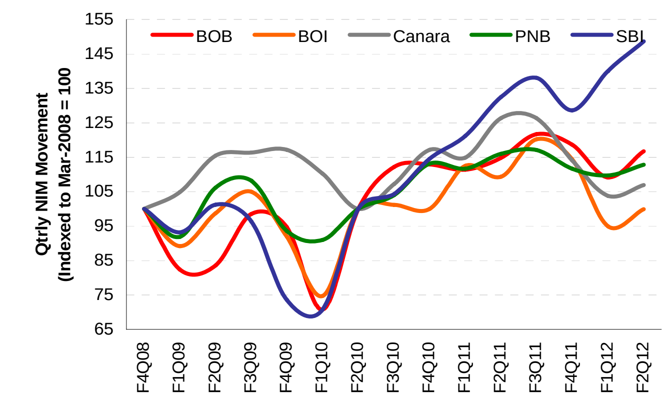
Source: Company data, Morgan Stanley Research

deposit costs to 8.5%). Other levers to margins – LD ratio came off 60bp QoQ to 74.7% and CASA ratio came off 27bp QoQ to 47.6%.

What is the outlook on NIM? Given the strong performance, SBI has increased its margin guidance for F2012 to average 3.65% from 3.5% previously.

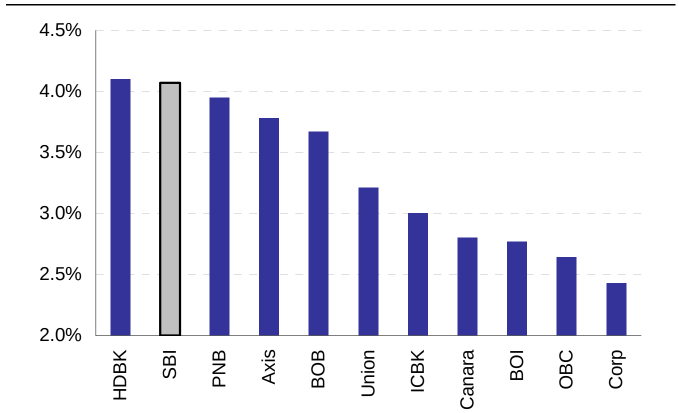
The NIM expansion at SBI was among the strongest in the peer group. Indeed, following the increase, its domestic margins are now broadly comparable to that of HDFC Bank – despite having a different loan mix and much lower capital and hence free funds contribution.

Exhibit 18
SBI's Margins Move Up to a New High



Source: Company data, Morgan Stanley Research

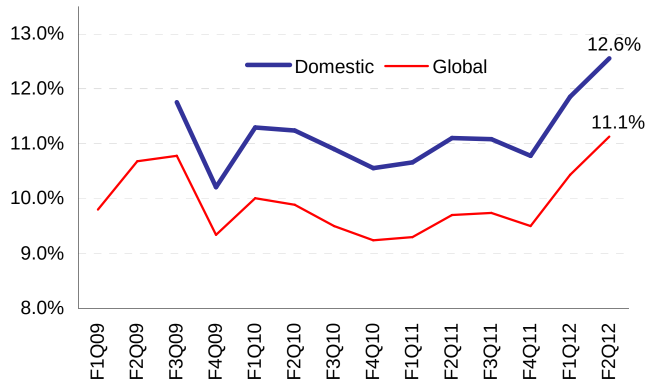
Exhibit 19
SBI's Domestic NIMs Now Among the Highest



Source: Company data, Morgan Stanley Research

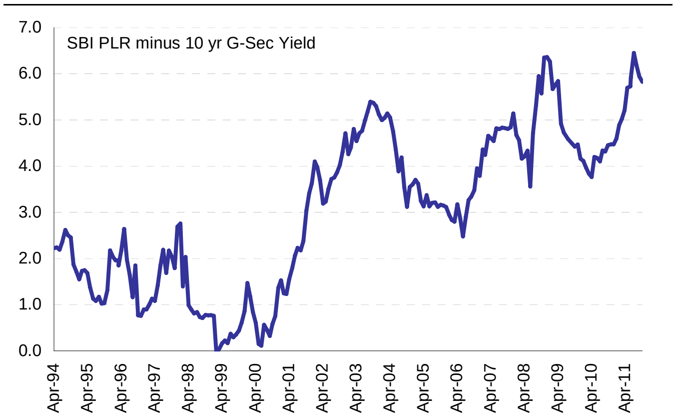
We have taken up our NIM estimates to reflect the strong F2Q12 performance. However, this is coming at a cost, in our view. Given that the bank is now charging ~12.6% on the entire domestic loan book – with large corporates paying much less – the marginal borrower is likely to be struggling, especially given the weak economic backdrop. We are building in 30bp NIM compression in F2013 as management will likely be forced to cut lending rates with corporates struggling – and higher NPLs will hurt as a larger portion of assets will generate zero yield.

Exhibit 20
SBI: Computed* Domestic Loan Yield Trend



Source: Company data, Morgan Stanley Research; Note: SBI only reports the year-to-date global yield on advances. We have used that to compute an approximate quarterly global yield. We then use Bank of India's international yield to derive SBI's domestic yield from this number.

Exhibit 21
Risk Spreads at Near-peak Levels



Source: Company data, Morgan Stanley Research

Exhibit 22
HDFC Bank and SBI Similar NIM's Now – But Higher NIMs Are Not Free

	SBI	HDFC Bank
NIM (Sept-11)	4.1%	4.1%
Credit Costs (As % of Loans)		
--- Average (F2007-11)	0.8%	1.6%

Source: Company data, Morgan Stanley Research

Volume Growth Was Tepid

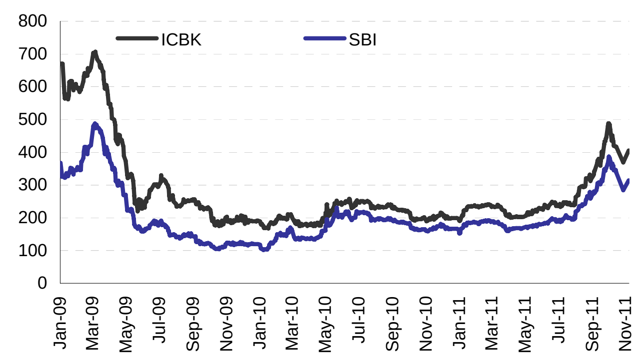
Total loans grew 3% QoQ and 17% YoY. The sequential growth this quarter was driven by international loans, which were up 13% QoQ (+19% YoY), aided by the impact of currency depreciation. Domestic loan book expanded by 1% QoQ (+17% YoY), moderating from +2% QoQ / +21% YoY in QE Jun-11.

Exhibit 23
SBI: Loan Mix

F2Q12	Rs bn	% of Total	%YoY	% QoQ
Large Corporate	1133	14%	21%	-4%
Mid Corporate	1613	20%	13%	1%
SME	1260	16%	21%	5%
International	1254	15%	19%	13%
Home Loans	924	11%	17%	3%
Education Loans	121	1%	16%	7%
Auto	220	3%	25%	2%
Personal	422	5%	0%	0%
Agriculture	958	12%	17%	0%
Others	200	2%	30%	7%
Total Loans	**8106**	**100%**	**17%**	**3%**
Memo:				
Infrastructure	738	9%	26%	NA

Source: Company data, Morgan Stanley Research;

Exhibit 24
CDS Spreads Have Been Trending Up Recently – Will Affect International Loan Growth Trend



Source: Company data, Morgan Stanley Research

Exhibit 25

USD/INR Has Risen Sharply; Will Also Weigh on International Loans Segment

Source: Company data, Morgan Stanley Research

Fee Income Growth Was Very Weak

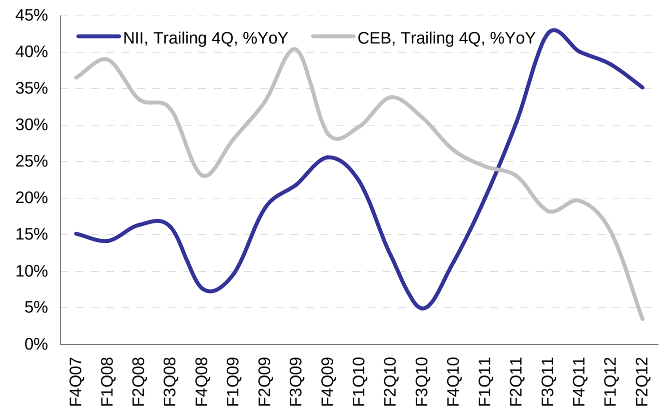
Fee income growth was very weak at -12% YoY. This compares with +9% YoY in QE June-11 and +40% YoY in QE Sep-10. SBI management indicated that part of the slowdown was due to two factors: 1) slowdown in loan originations; and 2) in the same quarter last year, it had a few large deals that generated large, chunky income, driving the YoY decline.

In our view, a part of the weakness in fee income could have been driven by a shift in mix by sacrificing fees to get higher loan spreads.

The volatile FX segment income was strong at +56% YoY (driven by a weak base and higher rupee volatility). Dividend income was also down sharply (-71% YoY) as SBI is now taking lower dividends from its banking subsidiaries (given that it was not tax efficient).

Exhibit 26

Fee Income Growth Continues to Decelerate



Source: Company data, Morgan Stanley Research

Operating Costs Were in Control

Operating costs were up 11% YoY. Employee expenses (outside of pensions/other one-offs) were up 7% YoY and non-employee expenses were up 18% YoY.

Exhibit 27

SBI: Costs Breakdown

(Rs million)	F2Q11	F1Q12	F2Q12	% YoY	% QoQ
---Employee Expenses	36758	37174	39143	6%	5%
-------Gratuity	2750	250			
-------Pension	5463	7282	8595	57%	18%
-------Others	28545	29641	30548	7%	3%
---Non Employee Expenses	20873	22740	24605	18%	8%
Total Operating Expenses	**57631**	**59913**	**63749**	**11%**	**6%**
Cost:Income	**48%**	**45%**	**46%**		
Cost:Avg Assets	**2.1%**	**2.0%**	**2.1%**		

Source: Company data, Morgan Stanley Research

Earnings Changes

At the parent level, we have lowered our EPS estimates for F2012 and F2013 by 2.2% and 12.8%, respectively. At the consolidated level, our EPS estimates have moved lower by 1.6% and 10.2%, respectively. While we are now factoring in higher margins (as detailed), this is more than offset by the lower fee income and higher credit costs (see below).

Exhibit 28

SBI (Parent) – What's Changed?

		OLD		NEW	
	F2011	F2012E	F2013E	F2012E	F2013E
Loan growth	20%	16%	16%	16%	14%
NIM	3.0%	3.1%	3.0%	3.3%	3.0%
NII growth	38%	21%	18%	31%	5%
Credit Costs / Loans	1.3%	1.0%	1.0%	1.3%	1.1%
Fee Income growth	20%	5%	12%	0%	10%
Core Revenue growth	31%	16%	16%	22%	6%
Core PPOP growth	54%	17%	10%	30%	-6%
EPS growth	-10%	28%	16%	25%	4%

e = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 29

F2Q12 Results Summary

	Rs Mln	F2Q11	F1Q12	F2Q12	% QoQ	% YoY
A	**Net Interest Income**	**79949**	**95665**	**104219**	**9%**	**30%**
	--CEB Income	29450	26329	26003	-1%	-12%
	--Forex Income	3087	3312	4806	45%	56%
B	**Core Non-Int Income**	**32537**	**29641**	**30810**	**4%**	**-5%**
	Staff Expenses	34008	36924	38893	5%	14%
	-- Pension	8213	7532	8595	14%	5%
	-- Others	25795	29391	30298	3%	17%
	Other Expenses	20873	22740	24605	8%	18%
C	Total Operating Expenses	54881	59663	63499	6%	16%
D	**Core pre-provision profit (A+B-C)**	**57605**	**65644**	**71530**	**9%**	**24%**
E	Loan Loss Provisions	21625	27817	29212	5%	35%
F	Other Provisions	272	3273	60	-98%	-78%
G	**Core Operating Profit (D-E-F)**	**35708**	**34554**	**42258**	**22%**	**18%**
	Gross Capital Gains	1973	1689	281	-83%	-86%
	Less Provisions for MTM	4318	10480	4583	-56%	6%
H	Net Capital Gains	-2345	-8791	-4302	-51%	83%
I	Other Non-Int Income	5542	4012	3182	-21%	-43%
	-- Dividends	2877	2278	840	-63%	-71%
	-- Others	2664	1735	2342	35%	-12%
J	One-offs:	-1550	1080	-250	NA	NA
	Interest on IT refund	1200	1330			
	Gratuity	2750	250	250		
K	**Reported PBT (G + H + I + J)**	**37355**	**30855**	**40888**	**33%**	**9%**
L	Income Tax Provisions	12342	15020	12784	-15%	4%
	Effective Tax Rate	33%	49%	31%	-36%	-5%
M	**Net Profit (K - L)**	**25014**	**15836**	**28104**	**77%**	**12%**
	OTHER KEY METRICS (Rs Bn)					
	Net Loans	6807	7709	7906	3%	16%
	Deposits	8553	9501	9732	2%	14%
	---Low cost deposit % (domestic) (Reported)	47.8%	47.9%	47.6%		
	Gross NPA	232	278	339	22%	46%
	Net NPAs	116	124	161	30%	39%
	Loan Loss Coverage	50.0%	55.2%	52.5%		
	Loan Loss Coverage (with tech/offs)	62.8%	67.3%	63.5%		
	Tier 1 Ratio	9.8%	7.8%	8.0%		
	LLP / Avg. loans (Ann.)	1.3%	1.5%	1.5%		
	Cost Income Ratio	48%	45%	46%		
	Cost to Income (ex cap gains) ratio	48%	46%	46%		

Source: Company data, Morgan Stanley Research; Note: Tier I ratio has been adjusted to include YTD profits.

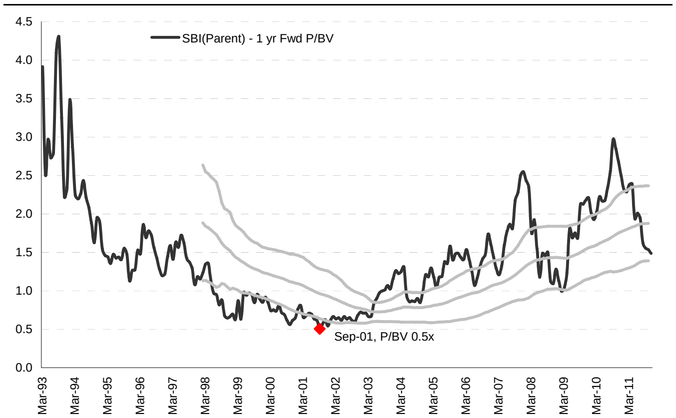
Exhibit 30
SBI Subsidiaries: F2Q12 Results Summary

Rs Mn	F2Q11	F1Q12	F2Q12	YoY	QoQ
Interest Income	68904	83350	88040	28%	6%
Interest Expenses	43977	57068	62362	42%	9%
Net Interest Income	**24927**	**26282**	**25678**	**3%**	**-2%**
Total Non-Interest Income	**7191**	**6789**	**8398**	**17%**	**24%**
Total Income	**32118**	**33071**	**34077**	**6%**	**3%**
Total Expense	**15763**	**15722**	**15847**	**1%**	**1%**
---Employee Expense	10649	10144	9708	-9%	-4%
---Other Expense	5114	5578	6140	20%	10%
Operating Profit	**16355**	**17349**	**18229**	**11%**	**5%**
Provisions	5075	6686	9086	79%	36%
PBT	**11280**	**10663**	**9143**	**-19%**	**-14%**
Tax	3230	3305	2200	-32%	-33%
-- Effective Tax Rate	29%	31%	24%		
PAT	**8051**	**7358**	**6943**	**-14%**	**-6%**
GNPLs	50987	57520	83247	63%	45%
NNPLs	23552	26514	46762	99%	76%
Coverage	27435	31005	36485	33%	18%
GNPL Ratio (Computed)	3.7%	3.7%	4.6%		
NNPL Ratio (Computed)	1.1%	1.1%	1.8%		
Coverage Ratio (Ex-tech w/offs)	54%	54%	44%		

Source: Company data, Morgan Stanley Research

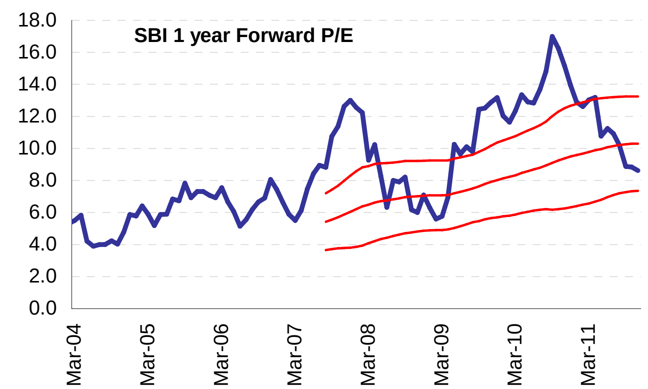
Valuation

Exhibit 31
SBI Bottomed at 0.5x BV in the Last NPL Cycle



Source: Company data, Morgan Stanley Research

Exhibit 32
SBI – (Consol) One-year Forward P/E



Source: Company data, Morgan Stanley Research

Price Target Discussion

We have lowered our price target for SBI from Rs1,550 to Rs1,350. Our new price target primarily reflects the following:

1) Lower earnings: At the parent level, we have trimmed our EPS estimates for F2012 and F2013 by 2.2% and 12.8%, respectively. At the consolidated level, our EPS estimates have moved lower by 1.6% and 10.2%, respectively. While we are now factoring in higher margins (as detailed earlier), this is more than offset by the lower fee income and higher credit costs.

2) Increased bear case weight: The combination of an aggressive increase in loan yields by SBI (and other banks), an increased uncertainty in global macro, and weak domestic trends (higher g-sec yields, weak export growth data, sharp currency depreciation) have increased the risk of asset quality being much worse that our base-case expectations. Hence, we are increasing our bear weight from 25% previously to 45% now.

Our base case weight reduces from 70% to 50% and bull case remains unchanged at 5%.

We have reduced our bull case value by 5% to Rs2,855 per share, and our base case value by 3% to Rs1,580 per share and our bear case value by 11% to Rs925 per share.

Please see page 3 for upside risks to our price target.

Exhibit 33

SBI – Sum-of-the-parts Valuation Scenarios

	Base	Bear	Bull	Wtd
Probability Weights	50%	45%	5%	
Ke	14.6%	14.6%	14.6%	
RI Based Value	**1460**	**850**	**2700**	**1250**
Implied Target P/BV (F2012E)	1.0	0.6	1.9	
Insurance	120	76	156	100
Total	**1580**	**925**	**2855**	**1350**

Source: Morgan Stanley Research estimates

We value SBI's two components on the following basis:

Consolidated banking business: We value the banking entities using a three-phase residual income model: a five-year high-growth period, a 10-year maturity period, followed by a declining period. We use a cost of equity of 14.6% (up from 14.3% previously owing to an increase in risk free rate), assuming a beta of 1.0, a risk-free rate of 8.9% (up from 8.5% previously owing to movements in Indian 10-year government bond yield), and a market risk premium of 5.5%.

Life insurance business: We use an appraised value method. We add to the embedded value the value of new business to get a value for the life business. We have revised our insurance subsidiary valuations downward moderately (base case value downward from Rs125 to Rs120; bear case value downward from Rs85 to Rs76 and bull case downward from Rs190 to Rs156). This change is driven by lower premium assumptions owing to recent trends in collections.

Exhibit 34

SBI – Life Insurance Valuation Scenarios

Rs Mn	Base Case	Bear Case	Bull Case
Embedded Value	56000	56000	56000
New Premiums, APE basis - F2013	34669	24300	43200
F2012-13 Growth YoY	8%	-10%	20%
NBAP Margin	14%	10%	16%
PV of 1 Yr New Business	4854	2527	6955
New Business Multiplier	14x	10x	16x
PV of new Business	67951	26283	111283
Appraised Value	123951	82283	167283
SBI's stake	74%	74%	74%
Value Attributable	91724	60889	123790
Value Per Share (Rs)	120	76	156

Source: Morgan Stanley Research estimates

State Bank of India (Parent): Financial Summary

Profit and Loss Statement				
Rs Mln (Year end-March)	**F2011**	**F2012E**	**F2013E**	**F2014E**
Interest Income	808444	1068792	1283521	1420223
Interest Expense	488680	649097	844148	914972
Net Interest Income	**319764**	**419695**	**439373**	**505251**
---Fee Income	115633	115342	126877	145908
---Forex Income	15871	15626	17969	21204
---Capital Gains	9257	3170	5000	7500
---Less:Dividend Income	8277	3932	4325	4757
---Miscellaneous Inc.	14708	10813	12435	14673
Total Non Interest Income	**163746**	**148882**	**166606**	**194042**
Total Operating Income	**483510**	**568577**	**605978**	**699293**
---Employee Exp	144802	160543	195183	239273
---Other Expenses	85353	103296	119823	137797
Total Operating Expenses	230155	263839	315006	377070
Operating Profit	**253356**	**304738**	**290972**	**322224**
---Prov. For Investment Dep.	6468	22062	5000	4000
---Loan Loss Provisions	97687	116794	103296	104095
Total provisions	103813	138697	109296	109095
Profit Before Tax	**149542**	**166041**	**181676**	**213129**
Provision for Tax	66897	60808	61770	72464
Net Profit for the year	**82645**	**105233**	**119906**	**140665**

Per Share Data and Valuations				
Year end-March	**F2011**	**F2012E**	**F2013E**	**F2014E**
Per Share Data (Rs)				
EPS	130.2	162.4	168.4	179.1
Book Value	1023.4	1163.2	1298.2	1433.3
DPS	30.0	32.5	34.0	39.0
Valuations				
PE	15.0	12.0	11.6	10.9
Price to Book	1.9	1.7	1.5	1.4
Dividend Yield	1.5%	1.7%	1.7%	2.0%

Ratio Analysis				
Year end-March	**F2011**	**F2012E**	**F2013E**	**F2014E**
Spread Analysis				
Average yield on assets	7.5%	8.5%	8.7%	8.3%
Cost of earning assets	4.5%	5.2%	5.7%	5.3%
Net Interest Margin (NIM)	3.0%	3.3%	3.0%	2.9%
Growth Ratios				
Net Interest Income	38%	31%	5%	15%
Non Interest Income	8%	-9%	12%	16%
Operating expenses	15%	15%	19%	20%
Operating Profit	38%	20%	-5%	11%
Net Profit	-10%	27%	14%	17%
EPS	-10%	25%	4%	6%
Deposits	16%	17%	15%	17%
Advances	20%	16%	14%	17%
Total Assets	16%	16%	16%	16%
Profitability Ratios				
Return On Equity	11.9%	14.7%	13.8%	13.1%
Return on Assets	0.7%	0.8%	0.8%	0.8%
Efficiency Ratios				
Cost Income Ratio	47.6%	46.4%	52.0%	53.9%
Expenses/Avg Assets	2.0%	2.0%	2.1%	2.1%
Capital Ratios				
Tier 1 Ratio	7.8%	8.3%	9.0%	8.6%
Tier 2 Ratio	4.2%	4.1%	3.5%	3.0%
Capital Adequacy Ratio	12.0%	12.4%	12.6%	11.6%

Balance Sheet Data				
Rs Mln (Year end-March)	**F2011**	**F2012E**	**F2013E**	**F2014E**
Share holders equity	649860	799854	1019601	1125673
Deposits	9339328	10906936	12542976	14675282
Borrowings	799451	919369	1057274	1237011
Other Liabilities & Prov.	1448722	1613406	1827066	2066775
Total Liabilities	**12237362**	**14239564**	**16446918**	**19104741**
Cash & Balances with RBI	943955	982558	1057194	1233598
Balances with Banks	284786	256308	299880	350860
Investments	2956006	3691618	4475896	5117400
Advances	7567194	8799389	10031304	11736625
Fixed Assets	47642	50024	54026	58348
Other Assets	437778	459667	528617	607910
Total Assets	**12237362**	**14239564**	**16446918**	**19104741**
Earning Assets	11751942	13729873	15864274	18438483
Asset Quality				
Annual LLP / Advances (bps)	127	133	105	90
Gross NPL	253263	419363	532390	631331
Net NPL	123469	205213	260341	307839
Reserve Coverage	129794	214150	272049	323492
Gross NPL Ratio	3.2%	4.5%	5.0%	5.1%
Net NPL Ratio	1.6%	2.3%	2.6%	2.6%
Coverage Ratio*	65%	61%	60%	60%

**Coverage Ratio includes Technical Write-offs*

e= Morgan Stanley Research estimates   Source: Company data, Morgan Stanley Research

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of October 31, 2011)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**1126**	**40%**	**449**	**44%**	**40%**
Equal-weight/Hold	**1176**	**42%**	**431**	**42%**	**37%**
Not-Rated/Hold	**108**	**4%**	**23**	**2%**	**21%**
Underweight/Sell	**418**	**15%**	**115**	**11%**	**28%**
Total	**2,828**		**1018**		

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Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
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Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.
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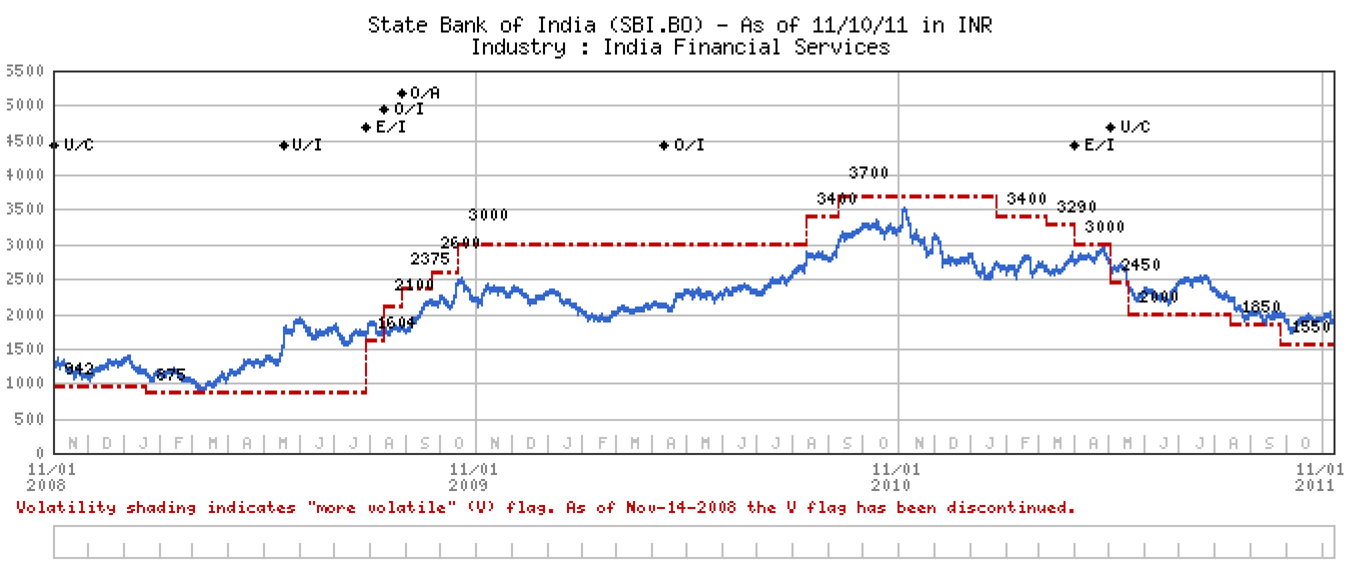
Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 11/1/08 : U/C; 5/18/09 : U/I; 7/29/09 : E/I; 8/14/09 : O/I; 8/28/09 : O/A; 4/12/10 : O/I; 4/1/11 : E/I; 5/2/11 : U/C
Price Target History: 7/4/08 : 942; 1/19/09 : 875; 7/29/09 : 1604; 8/14/09 : 2100; 8/28/09 : 2375; 9/23/09 : 2600; 10/16/09 : 3000; 8/13/10 : 3400; 9/9/10 : 3700; 1/24/11 : 3400; 3/9/11 : 3290; 4/1/11 : 3000; 5/2/11 : 2450; 5/18/11 : 2000; 8/15/11 : 1850; 9/27/11 : 1550

Source: Morgan Stanley Research   Date Format : MM/DD/YY   Price Target --   No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst)   Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:India Financial Services

Company (Ticker)	Rating (as of)	Price* (11/09/2011)
Anil Agarwal		
HDFC (HDFC.BO)	E (09/01/2010)	Rs680.1
HDFC Bank (HDBK.BO)	O (01/18/2010)	Rs477.45
ICICI Bank (ICBK.BO)	E (09/27/2011)	Rs861.75
State Bank of India (SBI.BO)	U (05/02/2011)	Rs1,862.5
Mihir Sheth		
AXIS Bank (AXBK.BO)	E (04/25/2011)	Rs1,112.05
Bank of Baroda (BOB.BO)	U (05/02/2011)	Rs789.1
Bank of India (BOI.BO)	U (05/02/2011)	Rs325.45
Canara Bank (CNBK.BO)	U (05/02/2011)	Rs476.6
Corporation Bank (CRBK.BO)	E (05/02/2011)	Rs424.25
IDBI (IDBI.BO)	U (10/21/2005)	Rs110.7
IDFC (IDFC.BO)	E (08/05/2010)	Rs122.65
ING Vysya Bank Ltd. (VYSA.BO)	E (12/22/2010)	Rs322.85
IndusInd Bank (INBK.BO)	O (09/27/2011)	Rs269.95
Kotak Mahindra Bank (KTKM.BO)	E (09/27/2011)	Rs494.1
LIC Housing Finance Ltd. (LICH.BO)	E (12/09/2010)	Rs231.85
Oriental Bank of Commerce (ORBC.BO)	E (05/02/2011)	Rs297.4
Punjab National Bank (PNBK.BO)	U (05/02/2011)	Rs968.45
Reliance Capital (RLCP.BO)	E (08/20/2008)	Rs358.8
Shriram Transport Finance Co. Ltd. (SRTR.BO)	E (02/25/2011)	Rs575.3
Union Bank of India (UNBK.BO)	E (05/02/2011)	Rs224.3
Yes Bank (YESB.BO)	O (10/20/2009)	Rs306.6

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* Historical prices are not split adjusted.