

**RESULTS FIRST LOOK**

Fresh loan delinquencies at INR 80bn against our expectation of INR 56bn spoil the 2QFY12 results. Operationally, NIM expanded strongly to 3.79% on the back of relatively higher (versus funding cost increase) loan yields and expanding margins on the international loan book. Management guided towards strong recoveries from large corporate accounts in the coming quarters and raised its NIM guidance for FY12 to 3.65% versus 3.5% earlier. We believe incremental slippages and recoveries in the quarters ahead will set the tone for the stock.

Price target: 2400.0 INR

Price (09 Nov 2011): 1862.05 INR

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**Slippages of INR 80bn spook the quarter, but expect recoveries ahead**

- Earnings vs. our Forecast: **ABOVE**

**Likely Impact:**

- Earnings Estimates: **NO CHANGE**
- Dividend Estimates: **NO CHANGE**
- Price Target: **NO CHANGE**
- Long-term View: **CONFIRMED**

**Earnings vs our forecasts**

- Diluted EPS came in 37% higher than our forecast largely because of strong NII performance with NIMs increasing to 3.7% versus 3.62% in 1QFY12 while NPL provisions were in line.
- Pre-provisioning profit was 10% higher than expected on the back of a 8% beat on NII (up 28% y/y) and lower opex (up 11% y/y), partly offset by a 5% miss on other income (down 14% y/y).
- Loan book growth was 16%/y/y (2% lower than forecast), while NIM was higher at 3.7% compared with our forecast of 3.45%.
- The GNPL ratio rose to 4.19% compared with our forecast of 3.64%, as slippages in the quarter came in at INR80bn (est. INR56bn) versus INR62bn in the previous quarter. Loan loss provisions were 160bps (annualized) for 2QFY12 compared with our forecast of 157bps.

**Key notes from the earnings meeting with management**

- **Recovery of bad loans** – Management guided towards a possibility of recovering INR 20 bn from large agri-based corporates. The seasonal turnaround in textiles and agri-based industries may also aid this process.
- **Power exposure** – has INR12bn exposure towards distribution companies and INR78bn to state-owned generation companies.
- **NIM expansion** – Management raised its FY12 guidance to 3.65% versus the earlier 3.5%. Sticky retail deposits, traction in savings accounts and repricing benefits arising from INR550bn term deposits raised earlier at 10.5%-11% should help in maintaining NIMs at these levels. Overseas book margins are expanding, 2QFY12 overseas NIM was at 1.73%.
- **Capital optimization:** The Tier-1 ratio could clock 9% without any capital infusion facilitated by full-year profits, unused working capital limit cancellation, ECGC book of INR300bn and SME credit enhancement. Management indicated a capital infusion of INR40bn from the government in the near future.
- **Growth driver** – Management guides towards 18-20% loan book growth for FY12 on account of strong traction in auto, mortgage and expected bounce back in agri, textile in 2HFY12. Some marginal traction on non-power infra and strong overseas book growth should also support the growth target.

## Other key highlights

- Slippages of INR80bn largely came from agri, iron & steel and textile sectors leading to a 22% sequential increase in gross NPLs to INR339bn. The gross NPL ratio and slippage ratio increased 67bps and 91bps sequentially to 4.19% and 4.43%, respectively.
- Of the total INR80bn slipped in the quarter, INR13bn slippage was on account of few agro-based companies owing to delay in harvest and diminution in value of cotton and mustard inventory.
- Overall restructured book was stable at INR354bn (4.5% of outstanding loans).
- Total reductions have been significantly lower at INR18bn for 2QFY12 INR37bn in the previous quarter largely owing to significantly lower write-offs and up-gradation.

Asset Quality (INRmn)	2QFY12	1QFY12	2QFY11	%y/y	%q/q	
Gross NPL	339,463	277,683	232,046	46.3	22.2	
Net NPL	161,205	124,352	116,012	39.0	29.6	
Gross NPL, %	4.19	3.52	3.35	84	67	bps
Net NPL, %	2.04	1.61	1.70	34	43	bps
Provision cover, %	52.51	55.22	50.00	251	(271)	bps
Reported Provision cover, %	63.50	67.25	62.78	72	(375)	bps
LLP, %	1.60	1.57	1.39	21	3	bps

Source: Company data, Nomura estimates

Movement in NPLs (INRmn)	2QFY12	1QFY12	2QFY11
Opening NPLs	277,683	253,263	208,252
Slippages	80,160	61,800	52,660
Less write offs	660	6,620	7,990
Less recoveries	7,360	11,990	20,870
Less up-gradations	10,360	18,770	NA
Total reduction	18,380	37,380	28,860
Closing NPLs	339,463	277,683	232,046
Last year's loans	6,807,495	6,532,200	5,722,140

Source: Company data, Nomura estimates

NPL - Industry break-up	2QFY12	2QFY11
Metals & Mining	477	412
Agro Based	1,268	145
Textiles	289	411
Gems & Jewellery	219	117
Hospitality	238	91
Paper/ Plastics etc	172	79
Others	2,034	2,422
<b>Total</b>	<b>4,697</b>	<b>3,677</b>

Source: Company data, Nomura estimates

- Loan book growth of 16% y/y was driven by 21%y/y growth in the SME book (5% q/q). The corporate and agri loan book grew at 16% and 17% y/y, respectively. Retail loan growth was slower than the overall book at 13% y/y as auto and mortgage book growth slowed down to 25% and 17% y/y, respectively, compared with 52% and 27%, respectively, in 2QFY11.

Breakup of loans (INRmn)	2QFY12	1QFY12	2QFY11	%y/y	%q/q
Corporate	3,999,662	3,899,810	3,448,075	16.0	2.6
SME	1,260,410	1,203,270	1,043,870	20.7	4.7
Agri	958,330	954,520	820,180	16.8	0.4
Retail Loans	1,687,610	1,651,310	1,495,370	12.9	2.2
Home loans	923,830	898,810	792,750	16.5	2.8
Education loans	121,399	113,590	104,980	15.6	6.9
Auto loans	220,254	215,450	176,020	25.1	2.2

Total Loans	7,906,012	7,708,910	6,807,495	16.1	2.6
International	1,253,640	1,107,120	1,054,760	18.9	13.2

Source: Company data, Nomura estimates

- CASA deposit growth was higher than deposit growth at 15% y/y, however, was flat q/q with term deposits growing 4%q/q. Saving deposits grew stronger at 16% y/y and current deposits grew 5% y/y. Owing to this, the CASA ratio declined 27bps sequentially to 47.6%.

Loans & Deposits (INRmn)	2QFY12	1QFY12	2QFY11	%y/y	%q/q	
Advances	7,906,012	7,708,910	6,807,495	16.1	2.6	
Saving Deposits	3,524,080	3,443,870	3,039,490	15.9	2.3	
Current Deposits	826,320	859,710	791,000	4.5	(3.9)	
CASA Deposits	4,350,400	4,303,580	3,771,400	15.4	1.1	
Term Deposits	5,381,311	5,197,140	4,722,960	13.9	3.5	
Total Deposits	9,731,711	9,500,720	8,553,450	13.8	2.4	
Domestic Deposits	9,172,890	8,998,850	8,077,740	13.6	1.9	
CASA, %	47.62	47.89	47.79	(17)	(27)	bps

Source: Company data, Nomura estimates

- The cost-income ratio increased 76bps sequentially at 46% largely owing to higher other opex.
- NIMs improved 17bps q/q to clock 3.79% driven by a 35bps q/q improvement in its loans yields compared with just an 18bps increase in cost of funds.
- Capital adequacy ratio of 11.4% with a tier-1 ratio of 7.74%.

Key Ratios	2QFY12	1QFY12	2QFY11	y/y bps	q/q bps
Net Interest Margin, %	3.79	3.62	3.43	36	17
Cost/Income Ratio, %	46.03	45.27	47.55	(152)	76
CASA, %	47.62	47.89	47.79	(17)	(27)
Tier I, %	7.47	7.60	9.62	(215)	(13)
Total CAR, %	11.40	11.60	13.20	(180)	(20)
RoA (annualised), %	0.87	0.50	0.87	-	37

Source: Company data, Nomura estimates

### Outlook for FY12/FY13F

- We estimate FY12F and FY13F loan book growth of 16% and 18%, respectively, and forecast fee income to grow at 16% in FY12F and by 20% in FY13F.
- The bank is guiding towards a NIM of 3.65% for FY12F. We estimate NIM to average at 3.47% for FY12F and FY13F, respectively, from 3.8% for 2QFY12.
- On NPLs, we are factoring in a slippage ratios of 2.6-2.8% compared with 1.8-2.4% over the last eight quarters to account for the incremental bad loans arising out of the high interest rate regime, power sector exposure. We are building in average LLPs of 155bps through FY12 and GNPL ratio of 4.63% for FY13F.
- We are building a capital infusion of INR50bn in 4QFY12F from the government.

**We maintain our Buy rating on the stock with a TP of INR2,400.**

Earnings summary (INRmn)	2QFY12	1QFY12	2QFY11	%y/y	%q/q	2QFY12F	%Variance
Interest on advances	197,889	182,564	145,808	35.7	8.4	186,775	6.0
Income on investments	58,534	54,138	48,044	21.8	8.1	54,498	7.4
Interest on balances with RBI	394	1,663	819	(51.9)	(76.3)	1,718	(77.1)
Others	2,855	3,610	3,411	(16.3)	(20.9)	4,131	(30.9)
Interest Income	259,671	241,974	198,081	31.1	7.3	247,121	5.1
Interest expended	155,452	144,979	116,932	32.9	7.2	150,999	2.9
Net Interest Income	104,219	96,995	81,149	28.4	7.4	96,122	8.4
Trading gains	281	1,689	1,973	(85.8)	(83.4)		

Other non-interest income	33,992	33,654	38,079	(10.7)	1.0		
Fees	26,003	26,329	29,450	(11.7)	(1.2)		
Others	7,988	7,324	8,629	(7.4)	9.1		
Total Non-interest income	34,272	35,342	40,052	(14.4)	(3.0)	36,162	(5.2)
Employee expenses	39,143	37,174	36,758	6.5	5.3	40,757	(4.0)
Other Operating expenses	24,605	22,740	20,873	17.9	8.2	23,811	3.3
Total Operating expenses	63,749	59,913	57,631	10.6	6.4	64,568	(1.3)
Operating Profit	74,743	72,424	63,570	17.6	3.2	67,716	10.4
Core operating profit	74,462	70,736	61,597	20.9	5.3		
Loan loss Provisions	29,212	27,817	21,625	35.1	5.0		
Total Provisions	33,855	41,569	26,215	29.1	(18.6)	36,202	(6.5)
PBT	40,888	30,855	37,355	9.5	32.5	31,514	29.7
Core PBT	40,607	29,167	35,382	14.8	39.2		
Tax	12,784	15,020	12,342	3.6	(14.9)	11,030	15.9
Net profit	28,104	15,836	25,014	12.4	77.5	20,484	37.2

Source: Company data, Nomura estimates

**Valuation Methodology and Investment Risks:** Valuation Methodology: We arrive at our target price of INR2,400 by calculating a subsidiary value of INR375 per share and adding INR2025 per share for the core bank business based on a three-stage residual-income valuation method. Our TP for the standalone bank implies 1.55x FY13F ABV of INR1,299 for an FY13F ROE of 17.1%. Risks: RBI persisting with a tight monetary policy, policy logjam with respect to power sector bottlenecks and continued global macro uncertainty.

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://go.nomuranow.com/research/globalresearchportal>) rather than the date of this email.

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Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
State Bank of India	SBIN IN	1862.05 INR	09 Nov 2011	Buy	

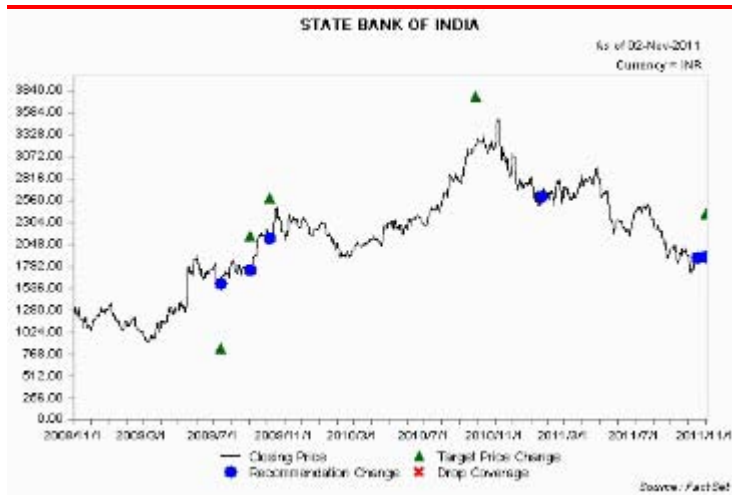
### Previous Rating

Issuer name	Previous Rating	Date of change
State Bank of India	Not Rated	31 Oct 2011

### State Bank of India (SBIN IN)

1862.05 INR (09 Nov 2011) Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
31-Oct-2011		2400.00	1906.70
31-Oct-2011	Buy		1906.70
17-Oct-2011	Not Rated		1891.80
21-Jan-2011	Suspended		2597.95
28-Sep-2010		3765.00	3190.25
08-Oct-2009		2590.00	2115.00
08-Oct-2009	Buy		2115.00
03-Sep-2009		2140.00	1747.15
03-Sep-2009	Neutral		1747.15
14-Jul-2009		830.00	1582.60
14-Jul-2009	Reduce		1582.60

For explanation of ratings refer to the stock rating keys located after chart(s)

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**Risks that may impede the achievement of the target price** RBI persisting with a tight monetary policy, policy logjam with respect to power sector bottlenecks and continued global macro uncertainty.

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