



State Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,243	SBIN IN
	REUTERS CODE
S&P CNX: 5,702	SBI.BO

27 October 2007

Buy

Previous Recommendation: Buy

Rs2,084

Equity Shares (m)	526.3
52-Week Range	2,104/845
1,6,12 Rel.Perf.(%)	-1/47/44
M.Cap. (Rs b)	1,097
M.Cap. (US\$ b)	27.6

YEAR	NET INCOME	PAT	EPS	CONS.	CONS.	P/BV	CONS.	CAR	ROE	ROA
END	(RS M)	(RS M)	(RS)	EPS (RS)	P/E (X)	(X)	P/BV (X)	(%)	(%)	(%)
3/07A	218,235	45,413	86.3	120.9	17.2	3.5	2.6	12.3	15.4	0.9
3/08E	250,385	57,054	108.4	145.4	14.3	3.1	2.2	11.2	17.0	0.9
3/09E	299,721	70,307	133.6	171.1	12.2	2.6	1.9	10.2	18.1	1.0

- ☞ SBI posted PAT of Rs16.1b in 2QFY08, higher than our estimate of Rs14.1b, though NII growth at 6% (to Rs38b) was lower than our estimate of 15% growth. Strong forex and treasury income growth, and lower provisions led to higher than estimated earnings growth.
- ☞ On a reclassified basis, NIM decreased to 2.84% in 1HFY08 v/s 3.02% 1HFY07 and 3.1% in 1QFY08. NIM for FY07 was 3.09%. Management expects NIM to improve going forward as credit growth picks up and yields on advances improve further.
- ☞ Deposits grew 23% YoY to Rs4.8t (QoQ increase of 8%) while advances increased by 27% YoY to Rs3.6t (QoQ increase of 6%). CASA deposits declined to 39.5% of domestic deposits as against 41.1% in 1QFY08.
- ☞ On core fee income, the bank recorded 12% YoY growth (Rs9.5b in 2QFY08 v/s Rs8.5b in 2QFY07), lower than our estimate of >15% growth. Treasury profits increased significantly from Rs82m in 2QFY07 to Rs4.35b in 2QFY08, led by equity trading. Forex income grew 108% to Rs2.6b in 2QFY08.
- ☞ Gross NPAs declined 1.2% QoQ in absolute amount, while net NPAs increased 6% QoQ. Gross NPAs are now at 2.9%, while net NPAs are at 1.6%. SBI made nil provisions on NPAs during 2QFY08 but reversed excess provision of Rs16m in 2QFY08.
- ☞ Adjusted for the value of SBI Life, the stock trades at 1.6x FY09E BV. We maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY07				FY08				FY07	FY08E
	1QA	2QA	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	84,786	87,996	97,359	115,415	110,905	116,163	125,456	137,837	384,542	490,360
Interest Expenses	49,466	52,593	57,846	72,213	68,891	78,534	83,246	89,253	234,368	319,923
Net Interest Income	35,320	35,403	39,513	43,201	42,014	37,629	42,210	48,584	150,174	170,437
% Change (Y-o-Y)					19.0	6.3	6.8	12.5	-3.7	13.5
Other Income	10,882	14,377	18,110	28,941	11,386	20,419	20,420	27,722	68,060	79,947
Net Income	46,202	49,780	57,623	72,142	53,400	58,049	62,630	76,306	218,235	250,385
% Change (Y-o-Y)					15.6	16.6	8.7	5.8	9.3	14.7
Operating Expenses	28,146	28,655	29,074	32,460	29,785	30,916	32,563	35,651	118,235	128,915
Operating Profit	18,056	21,125	28,549	39,682	23,615	27,132	30,067	40,655	99,999	121,469
% Change (Y-o-Y)					30.8	28.4	5.3	2.5	21.2	21.5
Other Provisions	2,511	3,213	11,662	14,126	1,594	857	12,500	21,363	24,096	36,314
Provision for Taxes	7,559	6,067	6,237	10,626	7,763	10,161	5,973	4,205	30,490	28,101
Net Profit	7,986	11,845	10,650	14,930	14,258	16,114	11,594	15,088	45,413	57,054
% Change (Y-o-Y)	-34.7	-2.5	-4.5	75.0	78.5	36.0	8.9	1.1	3.1	25.6
Cost to Income Ratio	60.9	57.6	50.5	45.0	55.8	53.3	52.0	46.7	54.2	51.5
Interest Exp / Interest Earned	58.3	59.8	59.4	62.6	62.1	67.6	66.4	64.8	60.9	65.2
Other Income / Net Income	23.6	28.9	31.4	40.1	21.3	35.2	32.6	36.3	31.2	31.9

E: MOST Estimates

Margins decline, as term deposits grow strongly

SBI has started deducting amortization on HTM investments from interest income. This was shown as a part of provisions in 2QFY07 and as a deduction from other income in 1QFY08. On a reclassified basis, NIM decreased to 2.84% in 1HFY08 v/s 3.02% 1HFY07 and 3.1% in 1QFY08. NIM for FY07 was 3.09%. Our estimate suggests that NIM for 2QFY08 was down QoQ by 50bp to ~2.6%, as term deposit growth remained strong and credit growth was subdued. The management expects margins to improve from current levels, as credit growth picks up from 3QFY08 and yields on advances improve further.

Yields on advances have increased by 129bp YoY to 9.84% in 1HFY08 and 4bp over 1QFY08 yields. Cost of deposits increased by ~97bp to 5.48% YoY in 1HFY08 (up 13bp from 1QFY08 levels). Yield on investments decreased to 6.34% in 1HFY08 from 6.94% in 1HFY07. As credit growth picks up from 3QFY08 and yields on advances improve; margins could improve for SBI. Management expects cost of deposits to go up further by a maximum of 15bp in 3QFY08, while yields would increase more on account of stronger growth expected in advances to mid-size companies, SMEs and retail clients.

YIELDS COSTS AND MARGINS (%)

	1HFY07	FY07	1QFY08	1HFY08
Avg Yield on Advances	8.55	8.67	9.80	9.84
Avg Yield on Investments	6.94	6.88	6.21	6.60
Avg Cost of Deposits	4.51	4.79	5.35	5.48
NIMs	3.02	3.09	3.10	2.84

Source: Company/Motilal Oswal Securities

Deposit growth at 23%, loan growth of 27%

Over the last 3-4 quarters, SBI's balance sheet growth has been picking up. Deposits grew 23% YoY to Rs4.8t (QoQ increase of 8%) while advances grew 27% YoY to Rs3.6t (QoQ increase of 6%). C-D ratio has decreased 100bp QoQ to 74%, up from 72% a year ago. Retail advances growth slowed down to 18%. The retail proportion in its loan book declined to 21.4% from 22.7% a year ago. Housing credit grew by 18% in 2QFY08 (52.5% of retail credit). CASA deposit proportion declined to 39.5% of domestic deposits as against 41.1% in 1QFY08. Term

deposits grew 29% YoY and 11% QoQ in 2QFY08 on account of higher interest rates offered on retail deposits.

DEPOSIT GROWTH (RS B)

	2QFY08	2QFY07	YOY GR. %	1QFY08	QOQ GR.%
Savings Account	1,389	1,239	12.1	1,359	2.2
Current Account	409	335	21.8	385	6.1
Term Deposits	3,044	2,352	29.4	2,752	10.6
Total Deposits	4,841	3,926	23.3	4,497	7.7

Source: Company/Motilal Oswal Securities

Treasury and forex boost other income, core fee income lower

On core fee income, the bank recorded 12% YoY growth (Rs9.5b in 2QFY08 v/s Rs8.5b in 2QFY07), lower than our estimate of >15% growth. Treasury profits increased from Rs82m in 2QFY07 to Rs4.35b in 2QFY08, led by equity trading. Forex income grew 108% to Rs2.6b in 2QFY08. Strong treasury and forex income enabled the bank to post 42% YoY increase in non-interest income and compensate for lower NII growth.

OTHER INCOME (RS M)

OTHER INCOME-NON	2QFY08	2QFY07	YOY % GR	1QFY08
FUND BASED REVENUE				
Fee Income	9,445	8,445	11.8	8,859
Trading Income	4,347	82	5,175	2,751
Forex	2,642	1,267	108	988
Invest. Rev. & HTM Amort.	823	-	NM	-7,118
Other Income	3,903	4,583	-14.8	5,907
Total	20,419	14,377	42	11,386

Source: Company/Motilal Oswal Securities

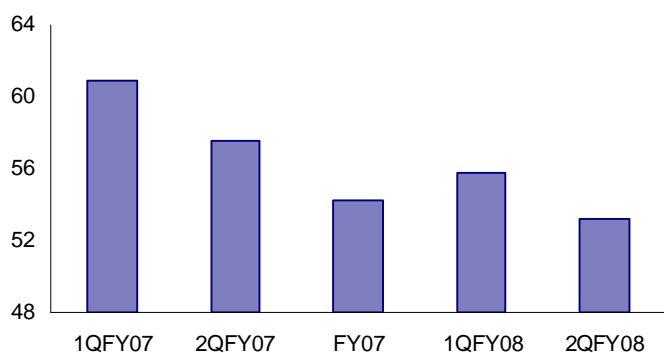
While fee income growth was not impressive in 2QFY08, we expect the management's thrust on fee income avenues to result in ~15% core fee income growth, going forward. With CBS now capturing more than 90% of the business, leakages from the system have reduced. Also, the bank is now charging processing fees for all loans; these were usually waived off, earlier. On the retail front, the bank has become very aggressive on third-party products and insurance distribution. Overall fee income is likely to witness strong growth over the next couple of fiscals.

Operating expenses under control

SBI continued to exercise strict control on operating costs, as total opex increased by just 6% YoY. Employee cost

grew 2% YoY and other opex grew 20% YoY. We believe that this will be a key earnings driver for SBI, as opex growth is likely to remain slower than overall business growth. Cost to income ratio in 2QFY08 has fallen 430bp YoY and 252bp QoQ to 53%. We believe that operating leverage would be a key earnings driver for SBI over the next few quarters.

COST TO INCOME RATIO (%)



Source: Company/Motilal Oswal Securities

Revised AS-15 impact is estimated to be ~Rs40b for SBI on account of transitional liability. SBI is currently making no provision for this amount. Management has not yet decided on whether to route this shortfall as one-time charge to reserves or 5-year amortization in income statement. In our projections, we have taken this charge through the income statement over the next five years starting from FY08.

Lower provisions boost profits

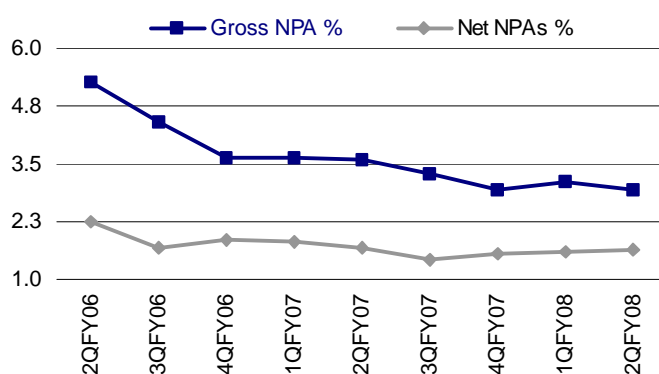
SBI made nil provisions on NPAs during 2QFY08 and reversed excess provision of Rs16m in 2QFY08. Gross addition to NPAs during 1HFY08 was Rs25b. Delinquency rate has reduced to 1.5% in 1HFY08, as compared to 1.9% in FY07. Nevertheless, delinquency trends continue to be high, and we are building higher NPA provisions, going forward.

Standard assets provision was lower at Rs662m in 2QFY08 v/s Rs1.4b in 2QFY07. Overall provisions excluding tax decreased 73% YoY and 46% QoQ to Rs857m in 2QFY08. Tax provision increased 68% YoY and effective tax rate was 39% in 2QFY08 v/s 35% in 1QFY08 and 34% in 2QFY08.

Asset quality remains stable

Gross NPAs declined 1.2% QoQ in absolute amount, while net NPAs increased 6% QoQ. Gross NPAs are now at 2.9%, while net NPAs are at 1.6%. Provision coverage reduced to 45% in 2QFY08 from 54% a year ago and 49% a quarter ago. Asset quality is robust and its proactive NPA management would enable SBI to further improve its asset quality.

NPA TREND



Source: Company/Motilal Oswal Securities

Consolidated profits increase 22% YoY

Consolidated NII grew 4% YoY while earnings grew 22% YoY. Consolidated other income increased 61% YoY on account of strong growth in insurance business and higher treasury profits at group level.

SBI Life maintained its strong growth trajectory with 79% YoY growth in new business premium in 1HFY08. The company has emerged as the third largest private life insurance company and continues to increase its market share. We believe SBI Life would be a key valuation driver for SBI, going forward.

Valuation and view

While margins should pick up over the 2QFY08 levels, overall margins are likely to be lower in FY08 than in FY07. However, operating leverage and higher fee and treasury income are likely to drive operating earnings. Announcements regarding capital raising, which are likely to happen over the next few weeks, could act as a near-term trigger. Adjusted for the value of SBI Life, the stock trades at 1.6x FY09E BV. We maintain **Buy**.

State Bank of India: an investment profile

Company description

State Bank of India (SBI) is the largest commercial bank in India, with a balance sheet size of over Rs5t. The bank, along with associate banks, has a network of over 14,000 branches across India and controls over 18% of the banking business. The government owns 57% of the bank, with FIIs owning 20% (maximum permissible is 20%). Over the last couple of years, SBI has been focusing on drawing significant synergies through an internal consolidation of its associate banks.

Key investment arguments

- ✎ Proxy to Indian economy; will benefit from up-tick in loan growth.
- ✎ Significant re-pricing of funds will result in stable margins.
- ✎ Associate banks have been performing well and add significant value.
- ✎ Natural attrition will pull down operating costs significantly over the next 3-4 years.

Key investment risks

- ✎ Management's focus on increasing market share may come at a cost of profitability.
- ✎ NPAs have been rising over few quarters and coverage ratio continues to be below industry average.

COMPARATIVE VALUATIONS

		SBI	PNB	BOI
P/E (x)	FY08E	14.3	8.7	10.0
	FY09E	12.2	7.3	8.4
P/BV (x)	FY08E	2.2	1.5	2.3
	FY09E	1.9	1.3	1.9
RoE (%)	FY08E	17.0	16.8	23.7
	FY09E	18.1	17.6	23.2
RoA (%)	FY08E	0.9	1.0	1.0
	FY09E	1.0	1.1	1.0

SBI P/E and P/BV are on consolidated basis

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	59.8	59.8	60.6
Domestic Inst	11.5	11.9	11.4
Foreign	19.8	19.8	19.8
Others	8.9	8.5	8.2

Recent developments

- ✎ Raised Rs9.2b of perpetual bonds qualifying for Tier I and 25.2b of upper Tier-II subordinated debt in 1QFY08.

Valuation and view

- ✎ We expect loan growth, stable margins to drive earnings growth over the next few quarters. Cost efficiency and NPA recovery will be the next big triggers for earnings growth.
- ✎ The stock trades 12.2x FY09E consolidated EPS and 1.9x FY09E consolidated BV. Maintain **Buy**.

Sector view

- ✎ YTD loan growth of 22% and deposit growth of 23%.
- ✎ Macro economic factors remain conducive for strong profitable growth for Indian Banks.
- ✎ Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- ✎ We maintain an overweight stance on the sector.

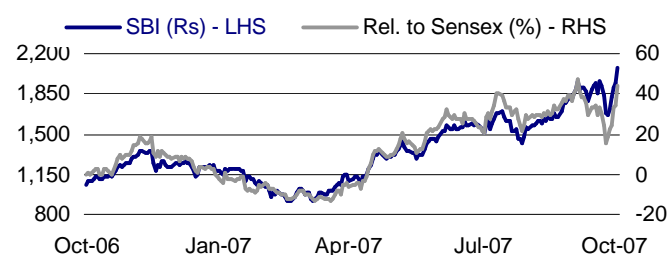
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	145.4	122.3	18.9
FY09	171.1	143.9	18.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,084	2,300	10.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2006A	2007	2008E	2009E	
Interest Income	359,796	384,542	490,360	591,280	
Interest Expended	203,904	234,368	319,923	386,727	
Net Interest Income	155,891	150,174	170,437	204,553	
Change (%)	11.8	-3.7	13.5	20.0	
Other Income	43,850	68,060	79,947	95,168	
Profit on sale of investment	5,872	5,678	10,000	8,000	
Other non-interest income	37,978	62,383	69,947	87,168	
Net Income	199,741	218,235	250,385	299,721	
Change (%)	-5.2	9.3	14.7	19.7	
Operating Expenses	117,251	118,235	128,915	143,139	
Employee expense	81,230	79,326	83,172	89,482	
Operating Income	82,490	99,999	121,469	156,582	
Change (%)	-24.9	21.2	21.5	28.9	
Provisions & contingencies	13,428	24,096	36,314	51,647	
Provision for NPAs	1,478	14,295	23,614	37,647	
PBT	69,062	75,903	85,156	104,935	
Tax	24,995	30,490	28,101	34,629	
PAT	44,067	45,413	57,054	70,307	
Change (%)	2.4	3.1	25.6	23.2	
Proposed Dividend	8,402	7,368	8,947	10,526	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2006A	2007	2008E	2009E	
Capital	5,263	5,263	5,263	5,263	
Reserves & Surplus	271,178	307,723	354,309	412,300	
Net Worth	276,441	312,986	359,572	417,563	
Deposits	3,800,461	4,355,211	5,226,253	6,010,191	
Change (%)	3.5	14.6	20.0	15.0	
CASA Ratio	47.6	48.5	46.5	46.5	
Borrowings	356,270	558,728	642,537	738,918	
Other Liabilities & Prov.	505,526	438,729	548,411	685,513	
Total Liabilities	4,938,696	5,665,653	6,776,772	7,852,184	
Current Assets	445,600	519,687	568,810	645,302	
Investments	1,625,342	1,491,489	1,715,212	1,972,494	
Change (%)	-17.5	-8.2	15.0	15.0	
Advances	2,616,415	3,373,365	4,182,973	4,894,078	
Change (%)	29.3	28.9	24.0	17.0	
Net Fixed Assets	27,529	28,189	31,562	34,273	
Other Assets	223,808	252,923	278,215	306,037	
Total Assets	4,938,696	5,665,653	6,776,772	7,852,184	

ASSUMPTIONS	(%)			
Deposit Growth	3.5	14.6	20.0	15.0
Advances Growth	29.3	28.9	24.0	17.0
Investments Growth	-17.5	-8.2	15.0	15.0
Dividend	140.0	140.0	170.0	200.0

E: M OSt Estimates

RATIOS		2006	2007	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets		8.0	7.7	8.3	8.5
Avg. Cost-Int. Bear. Liab.		5.1	5.2	5.9	6.1
Interest Spread		2.9	2.5	2.4	2.4
Net Interest Margin		3.4	3.0	2.9	3.0

Profitability Ratios (%)		2006	2007	2008E	2009E
RoE		17.0	15.4	17.0	18.1
RoA		0.9	0.9	0.9	1.0
Int. Expended/Int. Earned		56.7	60.9	65.2	65.4
Other Inc./Net Income		22.0	31.2	31.9	31.8

Efficiency Ratios (%)		2006	2007	2008E	2009E
Op. Exps./Net Income		58.7	54.2	51.5	47.8
Empl. Cost/Op. Exps.		69.3	67.1	64.5	62.5
Busi. per Empl. (Rs m)		30.5	38.2	45.5	53.3
NP per Empl. (Rs lac)		2.2	2.4	3.0	3.7

Asset-Liability Profile (%)		2006	2007	2008E	2009E
Adv./Deposit Ratio		68.8	77.5	80.0	81.4
Invest./Deposit Ratio		42.8	34.2	32.8	32.8
G-Sec/Invest. Ratio		85.0	81.2	81.2	81.2
Gross NPAs to Adv.		3.6	2.9	2.5	2.5
Net NPAs to Adv.		1.9	1.6	1.3	1.2
CAR		11.9	12.3	11.2	10.2
Tier 1		9.4	8.3	7.3	6.5

VALUATION		2006	2007	2008E	2009E
Book Value (Rs)		525.3	594.7	683.2	793.4
Price-BV (x)		4.0	3.5	3.1	2.6
Adjusted BV (Rs)		464.6	529.8	615.8	718.9
Price-ABV (x)		4.5	3.9	3.4	2.9
EPS (Rs)		83.7	86.3	108.4	133.6
EPS Growth (%)		2.4	3.1	25.6	23.2
Price-Earnings (x)		24.9	24.2	19.2	15.6
OPS (Rs)		156.7	190.0	230.8	297.5
OPS Growth (%)		-24.9	21.2	21.5	28.9
Price-OP (x)		13.3	11.0	9.0	7.0

E: M OSt Estimates



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State Bank of India

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|---|-----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | Yes |
| 4. Investment Banking relationship with company covered | No |

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