

State Bank Of India
Rs 869
Buy

22nd May 2006

SCRIP DETAILS

Market Cap (Rs Cr)	45,735
P/E (x)-FY07 (e)	8.7
P/BV (x) FY07 (e)	1.4
P/ Adj BV (x) FY0 (e)	1.7
Dividend (Rs)/ Yield (%)	14/1.8

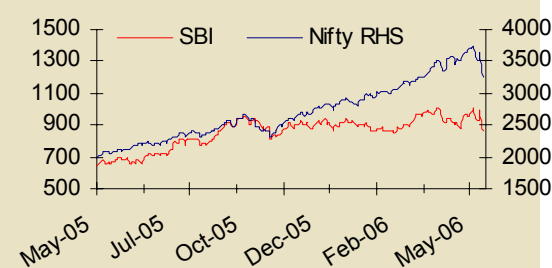
Equity Capital (Rs Cr)	526.0
Face Value (Rs)	10.0
52 Week High/Low (Rs)	1,020/ 574

 Website: www.sbi.co.in

NSE Code	SBIN
Sensex	10,938
Nifty	3247

**SHARE HOLDING PATTERN
(As on 31st March, 2006)**

Govt of India	59.7
Mutual Funds/ Banks/ FIs	11.5
FII's	19.9
Others	2.4
Public	6.5

COMPARATIVE PRICE MOVEMENT


State Bank Of India reported disappointing results for Q4FY06. Lower interest on investments on one hand and higher mark to market loss in its investment portfolio due to rising yields on the other, were the two major reasons for declining profits during the quarter. However, on the positive side, the fee income of the Bank witnessed strong growth during the quarter and for the full year. Further, the Bank has reported strong growth in its core income during the year and the results in FY07 will reflect the true growth of the Bank, as FY06 involved a lot of adjustments, both on account of tax refunds and IMD redemptions.

Downward repricing of investments led to NII degrowth: SBI's investment portfolio continued to see downward re-pricing, with high coupon bonds getting re-priced with lower coupon bonds and this resulted in a 21.6% decline in the interest on investments, to Rs 3,316 crores from Rs 4,228 crores in Q4FY05. These declining interests on investments resulted in interest income coming down by 1.6%, even though the core interest on advances grew by 37% during the quarter. However, the Bank managed to bring down its cost of deposits by 3 bps qoq; as a result, the interest expenses grew by a modest 5.5%, to Rs 4,955 crores.

Strong fees income powered growth in other income: In Q4FY06, treasury income fell sharply to Rs 80 crores, from Rs 210 crores in Q4FY05, due to rise in interest rate; however, strong growth in fee income, up by 32.2%, more than compensated the fall in other income, which was up by 58% during the quarter. Further, the Bank plans to bring its services charges in line with other markets, which are still lower, and this should help in fee-income growing strong in FY07.

NIM pressure short-term in nature: The Bank continued to feel the pressure on margins and NIM declined to 2.92%, a drop of 22 bps yoy and 9 bps drop qoq. The decline in NII together with the Bank's inability to raise the lending rates, were the prime reasons for pressure in margins during the quarter. However, the Bank has recently raised its PLR by 50 bps, which implies that the loan advances at Sub-PLR rates will also be re-priced upwards and, with 70% of the Bank's total advances being in the Sub-PLR segment, the interest income will see a strong rebound during FY07 and the Bank expects its NIM to expand by at least by 10 bps.

Higher Provisioning due to MTM loss: On account of rising yields, the Bank had to take a Rs 1,200 crores mark to market hit in its investment book during Q4, which led to a decline in the bottomline by 20%, to Rs 853 crores from Rs 1,065 crores in Q4FY06. For FY06, the MTM loss was to the tune of Rs 4,043 crores, as compared to Rs 2,287 crores in FY05, as a result of which the net profit growth was restricted to 2.4%, at Rs 4,406 crores. But on the positive side, the loan loss provisions were substantially lower, at Rs 147 crores for FY06, as against Rs 1,204 crores in FY05, implying the improvement in the asset quality. Further, in FY07 the MTM loss is likely to be lower than the current year, which should boost the bottomline, going ahead.

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Business growth remained strong: Loan growth remained strong during the year, up by 29.3% to Rs 2,61,642 crores. Retail advance posted a strong growth of 31.5% and accounted for 25.4% of the loan book. Agriculture loan posted the highest growth during the year, up by 38.4%. Deposits growth remained subdued, up by only 3.5%, at Rs 3,80,046 crores. However, the low growth was on account of the redemption of IMD to the tune of Rs 25,629 crores. For FY07, the Bank has targeted a loan growth of 23% and deposit growth of 16%.

Asset quality continued to improve: The asset quality of the Bank continued to improve during the quarter, both due to upgradation of bad assets involved in Dhabol Projects and a good amount of recovery. The Bank made cash recovery of Rs 3,461 crores in FY06, of which 1,041 crores were recovered from the written-off accounts alone. The gross NPAs declined to 3.88%, from 5.96% in FY05, and the net NPAs to 1.87%, from 2.65% last year. By FY07, the Bank expects its Gross NPAs to come down to 3% and net NPAs to 1.5%. Further, the bank has written-off accounts to the tune of Rs 6,500 crores and expects to recover around Rs 800 -900 crores during FY07.

Unlocking of value in associate banks to be a big positive: SBI has seven associate banks, where it has ownership between 74-100%. The associate banks together have a deposit base of Rs 1,61381 crores and advances of Rs 1,09,878 crores, reporting growth of 19% and 32%, respectively, during FY06. The operating profits of these banks put together were Rs 4,030 crores, while net profit was Rs 1,550 crores. The asset qualities of these banks are better than that of SBI's, on a standalone basis.

Financials

<i>All figures (in Rs crores)</i>	Q4FY06	Q4FY05	Chg (%)	FY06	FY05	Chg (%)
Interest income	8,509.1	8,647.5	-1.6	35,794.9	32,428.0	10.4
Interest expense	4,954.5	4,696.9	5.5	20,159.3	18,483.4	9.1
Net Interest Income	3,554.6	3,950.7	-10.0	15,635.6	13,944.6	12.1
Other Income	2,677.0	1,690.6	58.3	7,388.7	7,119.9	3.8
Total Operating income	6,231.6	5,641.25	10.5	23,024.3	21,064.5	9.3
Total Operating expenses	2,954.42	2,717.19	8.7	11,725.1	10,074.2	16.4
Cost/income	47.4%	48.2%		50.9%	47.8%	
Operating Profit	3,277.2	2,924.4	12.1	11,299.2	10,990.4	2.8
Core Operating Profit	3,197.2	2,714.3	17.8	10,712.1	9,215.1	16.2
Provisions	1,339.1	1,672.2	-19.9	4,393.1	4,468.8	-1.7
PBT	1,938.0	1,251.9	54.8	6,906.2	6,521.6	5.9
Taxes	1,084.7	187.0	480.0	2,499.5	2,217.1	12.7
PAT	853.3	1,064.9	-19.9	4,406.0	4,304.5	2.4
Equity Share Capital	526.3	526.3		526.3	526.3	
EPS (Rs.)	16.2	20.2		83.7	81.8	

In Rs Crores	Q4FY06	Q4FY05	Chg (%)	FY06	FY05	Chg (%)
Advances	2,61,642.0	2,02,374.0	29.3	2,61,642.0	2,02,374.0	29.3
Deposits	3,80,046.0	3,67,048.0	3.5	3,80,046.0	3,67,048.0	3.5
Gross NPAs	10,375.8	1,245.3		10,375.8	1,245.3	
Net NPAs	4,906.4	5,348.9		4,906.4	5,348.9	
Gross NPAs %	3.9	5.9		3.9	5.9	
Net NPAs %	1.9	2.7		1.9	2.7	
ROA %	0.69	0.94		0.89	0.99	
ROE %				15.5	18.1	
NIM %				2.92	3.39	
CAR %	11.9	12.5		11.9	12.5	

Valuation and Conclusion

SBI reported disappointing results for the quarter, which is short-term in nature. The NII witnessed de- growth, largely due to the downward re-pricing of its investment portfolio, which led to a sharp fall in the interest component. However, the core interest income i.e. the interest on advances continued to grow very strongly, up by 37% for the quarter. Further, with lending rates being revised upwards, it is likely to further accelerate in FY07. Additionally, the NIM of the Bank is likely to see some improvement during the year. During FY07, business growth will also be strong, with the bank targeting advances growth of 23% and deposit growth of 16%. Moreover, now the management is seriously thinking of unlocking the value in its various associate banks in the next few quarters, which will lead to re-rating of the stock. At the CMP of Rs 869, the stock is attractively valued at 8.7x its FY07 (e) of Rs 100 and 1.4x and 1.7x its FY07 BV and Adj BV of Rs 605 and Rs 512, respectively. On a consolidated basis, it is trading at 7x its FY07 (e) EPS of Rs 125 and 1.1x and 1.3x its FY07 (e) BV and Adj BV of Rs 800 and Rs 690, respectively. We continue to remain positive about the Bank's performance, going ahead and advise investors to **BUY** at current levels, with a one-year target price of Rs 1,200, implying up side of 38% in 12 months.

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