

India Update

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Highlights

Sector/event	Impact
BANKING: State Bank of India (SBI) – Company update	Our recent visit to SBI indicated that although rapid interest increases has hurt its bond portfolio, the core business outlook continues to improve. On the back of improved bargaining power with customers and control on funding costs, margins are likely to improve 10-15bps YoY in FY07E. The hit on profits due to the recent pension increase is not as much as initially apprehended, and can even be mitigated by SBI's supposedly well-funded corpus. Retail NPLs, which are currently around 3%, should improve with the ongoing project on centralised processing for retail credit. With part-reversal of the reduction in the government business fees, increase in service charges on 35 products and introduction of charges on some more, fee income growth could be the key upside in FY07. We, however, warn that SBI's excess SLR portfolio makes it vulnerable to investment depreciation/amortisation as rates rise and they tend to cap the upside to the stock price. Maintain BUY.

News Snippets

Economy

- Unlisted companies would now be permitted to sponsor an issue of ADR/GDR with an overseas depository. (Business Line)
- RBI has asked SEBI and the Government to exercise caution on the proposal to introduce a revised stock lending and borrowing programme for institutional investors as it might be violating the provisions of the Foreign Exchange Management Act. (The Economic Times)

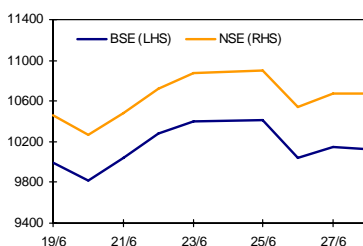
Sectoral

- MRTPC has asked its investigation arm to probe into the suspected cartelisation in the cement sector. (The Economic Times)

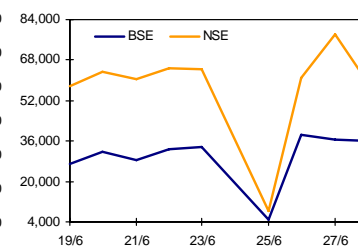
Corporate

- Tata Coffee plans to float a special purpose vehicle to fund its leveraged buy-out of the US-based Eight O'Clock Coffee company. (Business Line)
- Suzlon gets shareholder approval to raise Rs50bn through a combination of equity and debt-linked instruments. (Business Line)
- Niko Resources has reported a trebling of RIL gas reserves in KG basin to 35.4tcf. (Business Standard)

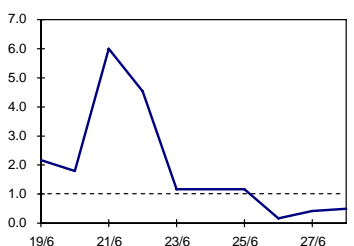
Market movement over last fortnight



Volumes in Rs mn (BSE and NSE)



Advances & Declines ratio (BSE)



Market data as on June 28, 2006

INDICES		
		% chg (DoD)
BSE Sensex	10130	(0.2)
S&P CNX Nifty	2981	(0.0)
BSE 100	5140	(0.3)
BSE 200	1215	(0.2)
Instanex Skindia DR	1523	(2.1)
Mindex	3778	1.4

OVERSEAS MARKETS

		% chg (DoD)
Dow Jones	10974	0.4
Nasdaq Comp.	2112	0.6
S&P 500	1246	0.5
Hang Seng	15743	(0.2)
Nikkei	14886	(1.9)

ADVANCES/DECLINES (BSE)

Group	A	B1	B2
Advances	70	207	287
Declines	130	445	509
Unchanged	0	12	37

FII TURNOVER (BSE+NSE)* (Rs mn)

Bought	Sold	Net
17,356	18,466	(1,110)

NEW HIGHS AND LOWS (BSE)

Group	A	B1	B2
Highs	-	-	3
Low	5	9	6

CURRENCY

US\$1 = Rs46.39

* FII turnover (BSE + NSE) as on June 27, 2006

State Bank of India (Buy)

BANKING

Core competence brings succour

Rs715

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Our recent visit to State Bank of India (SBI) indicated that although rapid interest increases has hurt its bond portfolio, the core business outlook continues to improve. On the back of improved bargaining power with customers and control on funding costs, margins are likely to improve by 10-15bps YoY in FY07E. The hit on profits due to the recent pension increase is not as much as initially apprehended, and can even be mitigated by SBI's supposedly well-funded corpus. Retail NPLs, which are currently around 3%, should improve with the ongoing project on centralised processing for retail credit. With part-reversal of the reduction in the government business fees, increase in service charges on 35 products and introduction of charges on some more, fee income growth could be the key upside in FY07. We, however, warn that SBI's excess SLR portfolio makes it vulnerable to investment depreciation/amortisation as rates rise and they tend to cap the upside to the stock price. Maintain BUY.

Table 1: Valuation summary (Standalone)

		Y/E March	EPS (Rs)	P/E (x)	P/BV (x)		
Price (28/06/06) (Rs)	715	2004	69.9	10.2	1.9	BSE Sensex	10130
52 Week Range (Rs)	1015/641	2005	81.8	8.7	1.6	Market Cap. (Rs bn)	376.2
Dividend FY06 (Rs/sh.)	14.0	2006	83.7	8.5	1.4	Market Cap. (US\$ bn)	8.1
Dividend Yield (%)	2.0	2007E	92.4	7.7	1.2	Shares Out. (mn)	526.3
Face Value (Rs)	10.0	2008E	118.3	6.0	1.0	Free float (%)	40.3

Source: Company data, i-SEC Research

Table 2: Valuation summary (Consolidated)

		Y/E March	EPS (Rs)	P/E (x)	P/BV (x)		
Price (28/06/06) (Rs)	715	2004	105.1	6.8	1.4	BSE Sensex	10130
52 Week Range (Rs)	1015/641	2005	103.8	6.9	1.2	Market Cap. (Rs bn)	376.2
Dividend FY06 (Rs/sh.)	14.0	2006	105.1	6.8	1.1	Market Cap. (US\$ bn)	8.1
Dividend Yield (%)	2.0	2007E	137.2	5.2	0.9	Shares Out. (mn)	526.3
Face Value (Rs)	10.0	2008E	159.8	4.5	0.8	Free float (%)	40.3

Source: Company data, i-SEC Research

- **A 10-15bps margin improvement likely despite tough environment.** As against 2.92% NIM registered in FY06 (excluding exceptionals), the bank expects to reach 3.05-3.10% in FY07E, primarily on the back of increase in yield on advances and control on funding costs. SBI's excess 9% SLR, some shift in incremental deposits from higher to lower maturity brackets and rapidly growing CASA should maintain control on cost of resources. The bargaining position of banks, including SBI, has improved considerably in recent times, both as a result of tighter liquidity and some informal agreements to avoid undercutting. Credit demand is not a concern and the bank is on track to maintain its 24% loan growth target given at the beginning of the fiscal. The only major negative is the recent RBI decision to stop paying interest on CRR balances, which will cost SBI Rs2.3bn in interest income every year.
- **Pension increase hit not as much as apprehended.** SBI estimates (subject to the final government order awaited) the additional cash flow required per annum on increased pensions to be Rs650mn, which implies an increase of approximately Rs8.5bn in the corpus. However, such a provision can be spread over many years. Also, it is widely believed (though not confirmed by the management) that SBI's pension scheme was over-funded – in which case some of the impact can be absorbed.

- **Retail NPLs should come under control soon.** Centralised processing of retail credit, now being rolled out in 85 cities (150 by March '07), should mitigate the problem of high retail delinquencies (around 3% gross). This facilitates standardised practices and builds more borrower knowledge, something that the erstwhile branch-led retail lending could not achieve. SBI is one of the first PSU banks to do this, though it is late compared with private banks. Development of the credit bureau, CIBIL, should also help. SBI has already seen and prevented some attempts at multiple borrowings on the same property.
- **Fee income could be a major positive in FY07.** The reduction in government business came as a bolt from the blue in FY06, but that has been partially reversed already. It is hoped that with rapid increase in government business volumes, there is some scope for a further fee rate increase. However, regardless of the possibility, SBI has raised service charges on 35 products and introduced charges on many erstwhile free services. Therefore, our 10% fee income growth assumption for FY07E (12.7% in FY06) could be on the lower side.

Recent reports/updates		
Analyst	Company/Sector	Date
Rajesh Vora	Dr. Reddy's Laboratories: Set to jet	June 23
Rajesh Vora	Ranbaxy Laboratories: Regeneration in the offing	June 22
Dipankar Choudhury	State Bank of India: 'Bond'ed labour	June 20
Dipankar Choudhury	OBC: Skewed equation	June 16
S. Ramesh	Netback margin: A scoring opportunity	June 15
Shilpa Gupta	Speedometer – June '06: Soaring high	June 14
Rajesh Vora	Pharma Sector: Time to log on to pharma	June 9
Anand Shah	Britannia Industries: Margin blues	June 7
Dipankar Choudhury	Bank of Baroda: Metamorphosis	June 5
Dipankar Choudhury	Corporation Bank: Down the rung	May 29
S. Ramesh	Indraprastha Gas: Rewarding times ahead	May 25
Eq. Research Team	Market strategy: Gear up for bargain hunting	May 22
R. Amarnath	Balaji Telefilms: 20:20 vision	May 17
Shilpa Gupta/Manish Jain	Speedometer – May '06: Unfolding prowess	May 15
Dipankar Choudhury	Dena Bank (Unrated): A new beginning	May 11
S. Ramesh	Netback margin: Uncharted waters	May 10
Dipankar Choudhury	Union Bank: Negotiating the headwind	May 10
Dipankar Choudhury	Innovative capital instruments: Capital leap	May 8
Dipankar Choudhury	UTI Bank: In major league	May 5
Rajesh Vora	Glenmark: Leveraging core strengths	May 5

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