Banks | India

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NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

SECTOR QUICK COMMENT

We benchmark the loan loss provisions factored into our Axis and SBI estimates with the stress test assumptions outlined by Moody's recently. For Axis, forecast LLPs of INR65bn over the next two years compare with INR44.2bn that would be required under the 'adverse scenario' and INR89.5bn under the 'extremely adverse scenario'. For SBI, expected LLPs of INR344bn would become INR244.3bn and INR496.2bn for the two scenarios, respectively. Based on our current conservative LLPs, Axis trades at 1.6x FY13F ABV for an ROE of 18.4% and SBI trades at 1x FY13F ABV for an ROE of 17.1%.

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Loan loss provisions under the Moody's stress tests

In the current credit cost cycle, we expect loan loss provisions for the Indian banking sector to increase from 72bps in FY11 to 119bps in FY12F and 123bps in FY13F – due to credit quality deterioration in sectors like power, aviation, SME etc. This compares with the past peaks of 156bps in FY97 and 119bps in FY04. In their recent Banking System Outlook for India, Moody's has detailed two stress case scenarios for asset quality – Adverse scenario and Extremely adverse scenario. The following table summarizes Moody's assumptions for probability of default, loss-given-default and expected loss for the various loan categories under these two scenarios.

Assumptions for stress tests	Adverse Scenario			Extremely Adverse Scenario		
Loan portfolio breakdown	PD	LGD	EL	PD	LGD	EL
corporate & commercial	5.00%	40.00%	2.00%	8.00%	50.00%	4.00%
export oriented	8.00%	50.00%	4.00%	13.00%	60.00%	7.80%
construction & real estate	12.00%	60.00%	7.20%	20.00%	70.00%	14.00%
SME	10.00%	50.00%	5.00%	18.00%	60.00%	10.80%
residential mortgage	3.00%	30.00%	0.90%	5.00%	40.00%	2.00%
personal / consumer	8.00%	60.00%	4.80%	15.00%	70.00%	10.50%
credit cards	20.00%	90.00%	18.00%	40.00%	95.00%	38.00%

Source: Moody's

In this note, we try to benchmark the provisions we have built into our estimates for Axis Bank and SBI through the next two years with the provisions that would have to be made under the two scenarios outlined by Moody's.

- We apply the expected loss percentages under Moody's adverse and extremely adverse scenarios to the loan book outstanding at the end of 2QFY12.
- Moody's loan classification does not explicitly carve out 'rural' loans – the expected loss percentages are our assumptions.

Axis — Moody's Loan Classification (INRmn)	2Q12 Loan Book	Loss % - Adverse	Loss % - Extremely Adverse	Loss - Adverse	Loss - Extremely Adverse
corporate & commercial	599,555.0	2%	4%	11,991.1	23,982.2
export oriented	80,660.5	4%	8%	3,226.4	6,291.5
construction & real estate	113,686.9	7%	14%	8,185.5	15,916.2
SME	207,550.0	5%	11%	10,377.5	22,415.4
residential mortgage	222,892.8	1%	2%	2,006.0	4,457.9
personal	64,521.6	5%	11%	3,097.0	6,774.8
credit cards	5,865.6	18%	38%	1,055.8	2,228.9
Rural	106,160.0	4%	7%	4,246.4	7,431.2
				44,185.8	89,498.0

Provisions factored in	**65,015.8**

Source: Moody's, Nomura estimates

SBI — Moody's Loan Classification (INRmn)	2Q12 Loan Book	Loss % - Adverse	Loss % - Extremely Adverse	Loss - Adverse	Loss - Extremely Adverse
corporate & commercial	3,388,980.0	2%	4%	67,779.6	135,559.2
export oriented	432,070.0	4%	8%	17,282.8	33,701.5
construction & real estate	178,610.0	7%	14%	12,859.9	25,005.4
SME	1,260,410.0	5%	11%	63,020.5	136,124.3
residential mortgage	923,830.0	1%	2%	8,314.5	18,476.6
personal	763,780.0	5%	11%	36,661.4	80,196.9
credit cards		18%	38%	-	-
Rural	958,330.0	4%	7%	38,333.2	67,083.1
				244,251.9	496,146.9
Provisions factored in				**344,144.7**	

Source: Moody's, Nomura estimates

Key points to note:

1) Axis Bank - The loan loss provisions built into our estimates for the next two years are INR65bn. This compares with INR44.18bn of losses that we believe would be likely under the adverse scenario and INR89.5bn under the extremely adverse scenario.

2) SBI - The loan loss provisions built into our estimates for the next two years are INR344.15bn. This compares with INR244.25bn of losses that we believe would be likely under the adverse scenario and INR496.15bn under the extremely adverse scenario.

3) Our current FY13F PAT for Axis and SBI is INR42.8bn & INR138.7bn – 12% and 6% below Bloomberg consensus, respectively.

4) AXSB currently trades at 1.6x FY13F adjusted book value, one standard deviation below its historical mean of 2.4x one-year forward ABV. Our TP of INR1,400 implies 2.4x FY13F ABV of INR 584 and 14.1x FY13E EPS of INR 99.62 for an ROA of 1.3% and ROE of 18.4%.

5) SBI trades at 1x FY13F ABV, one standard deviation below its historical mean of 1.7x one-year forward ABV. At our TP of INR2,400, SBI trades at 1.55x FY13F ABV of INR1,299 and 8.1x FY13F EPS of INR 209.67 for an FY13F ROA of 0.9% and adjusted ROE of 17.1%.

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.

Analyst Certification

We, Vijay Sarathi, Abhishek Bhattacharya and Amit Nanavati, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

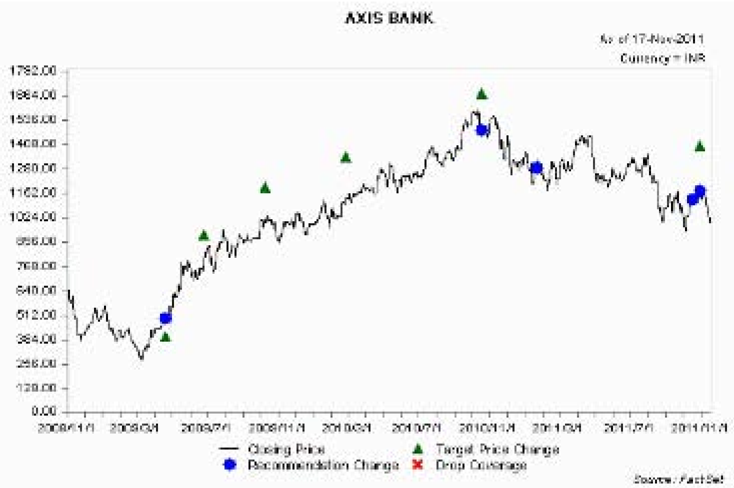
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Axis Bank	AXSB IN	947.0 INR	22 Nov 2011	Buy	
State Bank of India	SBIN IN	1689.5 INR	22 Nov 2011	Buy	

Previous Rating

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

Axis Bank (AXSB IN) 947.0 INR (22 Nov 2011) Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
31-Oct-2011		1400.00	1159.70
31-Oct-2011	Buy		1159.70
17-Oct-2011	Not Rated		1120.40
21-Jan-2011	Suspended		1284.40
18-Oct-2010		1675.00	1482.05
18-Oct-2010	Neutral		1482.05
25-Feb-2010		1345.00	1097.95
09-Oct-2009		1185.00	996.20
24-Jun-2009		935.00	768.65
21-Apr-2009		400.00	493.85
21-Apr-2009	Buy		493.85

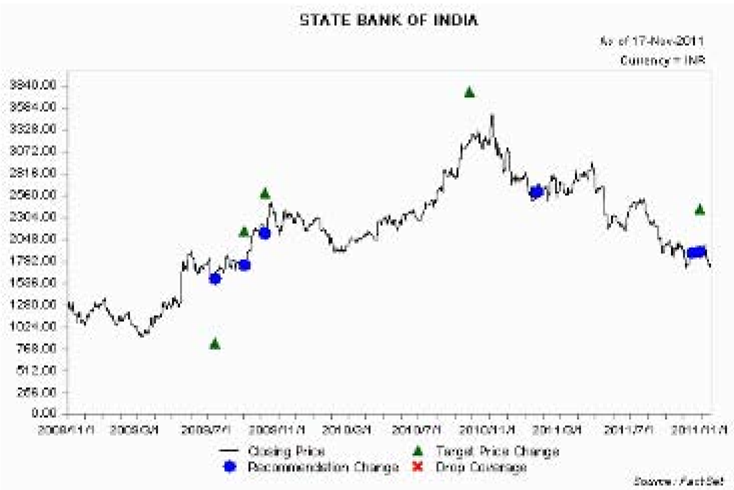
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We arrive at our TP of INR1,400 using a three-stage residual-income valuation methodology that assumes the following: 1) interest-earning assets CAGR of 21.9% over FY11-14F, 12.9% over FY13-20F and a terminal growth rate of 4% beyond that; 2) average ROE of 18.8% over FY12-20F and an 18.3% terminal value ROE; and 3) discount rates of 14.85% (current cost of equity) for FY11-14F, 12.25% for FY14-20F and a 10% terminal rate. Our TP of INR1,400 implies FY13F P/ABV of 2.4x. Our book value estimates also factor in 3.5% dilution towards the Enam acquisition.

Risks that may impede the achievement of the target price Accelerated monetary policy easing, policy intervention to resolve power sector bottlenecks, such as fuel availability and SEB (state electricity board) financial health, are key upside catalysts. RBI persisting with a tight money policy, policy inaction with respect to power sector bottlenecks and continued global macro uncertainty are potential downside risks.

State Bank of India (SBIN IN) 1689.5 INR (22 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)

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 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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Online availability of research and conflict-of-interest disclosures

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STOCKS

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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