

FIG
 Commercial Banks
 Equity – India

Underweight

Target price (INR)	2,000.00
Share price (INR)	1,940.55
Forecast dividend yield (%)	1.8
Potential return (%)	4.8

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-19.8	-23.5	-23.5
Relative^ (%)	-13.4	-13.0	-13.6

Index^ BOMBAY SE SENSITIVE INDEX

RIC SBI.NS
 Bloomberg SBIN IN

Market cap (USDm) 21,583
 Market cap (INRm) 1,173,702

Free float (%) 29

Note: (V) = volatile (please see disclosure appendix)

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State Bank of India (SBIN IN)

UW: Q4FY12 – A good quarter, but not the start of a trend

- ▶ **4Q earnings were above estimates due higher other income and lower credit costs; asset quality was much better than ours and street expectations, but margins declined q-o-q**
- ▶ **FY13 and FY14 likely to see margin compression along with sustained elevated credit costs; upcoming wage settlement to increase operating cost ratios**
- ▶ **Retain UW rating and target price at INR2,000, implying 4.8% potential return**

4QFY12 earnings came in at INR40.5bn, beating ours and street estimates. Improvement in asset quality both at gross and net levels along with higher provision cover was the key positive surprise, which resulted in the stock ending 5% higher than yesterday's close.

Highlights: Loan growth at 16% y-o-y was driven primarily by the growth in relatively lower yielding international segment (24% y-o-y), the riskier segments of farm credit (23% y-o-y) and SME (16.3%). Bank saw a significant impact of high interest rates on its CASA growth (6.4% y-o-y). CASA ratio, as a result, declined by 188bps y-o-y to 46.6%. However, bank is focusing on growing retail term deposits by banking on its branch network leading to just 2% y-o-y growth in bulk deposit against a 23% growth in retail deposits. Overall increase in funding costs resulted in NIM declining by 15 bps q-o-q to 3.9%. Asset quality improvement was a positive surprise for us as well as the street. Fresh slippages halved to 2% vs 4% in Q3 and recovery and upgradation exceeded slippages leading to a 17 bps decline in GNPLs. Provision coverage ratio also improved from 62% in 3Q to 68%, leading to a 40 bps q-o-q decline in NNPL ratio. Fresh additions to restructured book were INR51 bn; with this the total restructured book now stands at ~5% of loans.

Outlook: One quarter of good performance has not changed our outlook much, especially given the tough macro environment, tight liquidity, currency depreciation and high interest rates, which impacts corporates. We cut our FY13 and FY14 PAT estimates by 3.3% and 12%, respectively, as we build in margin compression, while largely retaining operating costs and credit costs estimates.

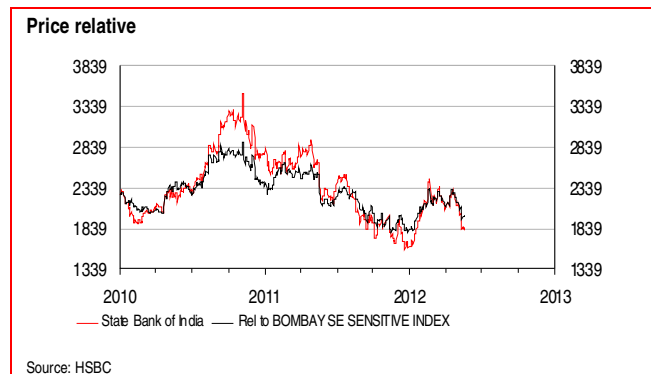
Valuation and risks: SBI currently trades at 12-month forward multiples of 9.8x PE and 1.4x PB against its average 5-yr multiples of 13x PE and 1.8x PB. It currently trades at 53% premium to PE and 47% premium to PB over its PSU peers, despite its lower RoE and RoA and therefore does not warrant any rerating. We retain our target multiples of 9.3x PE and 1.4x PB and retain our target price of INR2000. Retain Underweight. **Key upside risks:** 1) Upturn in economic cycle 2) asset quality improves

Financials & valuation

Year to	3/2011a	3/2012p	3/2013e	3/2014e
P&L summary (INR m)				
Net Interest Income	325,264	432,911	468,786	523,349
Non-interest Income	158,246	143,515	161,687	169,883
Net fees/commission	130,273	135,231	141,033	147,851
Trading profits	9,257	(9,197)	2,299	2,759
Other	18,716	17,481	18,355	19,273
Total Operating income	483,510	576,425	630,474	693,232
Operating expense	230,154	260,690	294,740	330,284
Staff costs	144,802	169,740	194,326	220,382
Other oper expense	85,353	90,949	100,414	109,902
PPOP	253,356	315,735	335,733	362,949
Provisions	103,813	130,902	134,894	139,527
Bad debt	87,921	115,459	122,039	127,503
Other	15,893	15,444	12,855	12,024
Other non-oper profit(loss)				
HSBC PBT	149,542	184,833	200,839	223,421
Exceptionals	-	-	-	-
Profit-before tax	149,542	184,833	200,839	223,421
Taxation	66,897	67,760	70,294	78,197
PAT	82,645	117,073	130,545	145,224
Minorities + pref dividend	-	-	-	-
Attributable profit	82,645	117,073	130,545	145,224
HSBC attributable profit	82,645	117,073	130,545	145,224
Balance sheet summary (INRM)				
Total assets	12,237,362	13,355,192	15,288,119	17,746,026
Customer loans (net)	7,567,194	8,675,789	9,951,907	11,525,259
Investment assets	2,956,006	3,121,976	3,437,723	3,875,307
Other assets	1,714,162	1,557,427	1,898,489	2,345,460
Total Liabilities	11,587,502	12,515,680	14,349,332	16,699,540
Customer deposits	9,339,328	10,436,474	12,097,633	14,164,608
Borrowings	1,195,690	1,270,056	1,334,310	1,521,924
Other liabilities	1,052,484	809,151	917,389	1,013,007
Total capital	649,860	839,512	938,787	1,046,486
Ordinary equity	649,860	839,512	938,787	1,046,486
Minorities + other capital				
IEA (avg)	10,853,670	12,170,194	13,562,204	15,581,859
IBL (avg)	9,803,148	11,120,774	12,569,236	14,559,238
Capital adequacy (%)				
RWA (INRM)	10,834,808	11,591,351	13,359,027	15,575,121
Core tier 1	7.8%	9.3%	8.9%	8.3%
Total tier 1	7.8%	9.8%	9.3%	8.7%
Total capital	12.0%	13.9%	12.4%	11.3%
Per share data (INR)				
EPS reported (fully diluted)	130.2	179.3	194.5	216.4
HSBC EPS (fully diluted)	130.2	179.3	194.5	216.4
DPS	30.0	35.0	40.0	48.0
NAV	1,023.4	1,251.1	1,399.0	1,559.5
NAV (including goodwill)	1,023.4	1,251.1	1,399.0	1,559.5
ROAA deconstruction				
Net interest income	2.86	3.38	3.27	3.17
Total interest income	7.15	8.32	8.24	7.91
Total interest expense	4.29	4.94	4.96	4.74
Net fees & commission	1.14	1.06	0.98	0.90
Other income	0.25	0.06	0.14	0.13
Operating income	4.25	4.50	4.40	4.20
Operating expenses	2.02	2.04	2.06	2.00
Staff costs	1.27	1.33	1.36	1.33
Other oper exp	0.75	0.71	0.70	0.67
PPOP	2.23	2.47	2.34	2.20
Provisions	0.91	1.02	0.94	0.84
Non-op items	-	-	-	-
PBT	1.31	1.44	1.40	1.35
Taxation	0.59	0.53	0.49	0.47
PAT	0.73	0.91	0.91	0.88

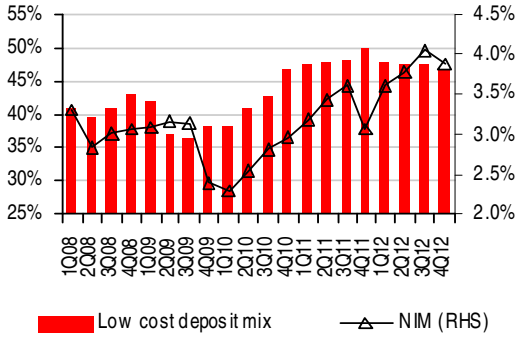
Year to	3/2011a	3/2012p	3/2013e	3/2014e
Growth (YoY %)				
Net interest income	37.4	33.1	8.3	11.6
Non-interest income	5.7	(9.3)	12.7	5.1
Operating expense	13.3	13.3	13.1	12.1
PPOP	38.3	24.6	6.3	8.1
Provisions	136.2	26.1	3.0	3.4
PBT	7.4	23.6	8.7	11.2
PAT	(9.8)	41.7	11.5	11.2
Customer loans (net)	19.8	14.7	14.7	15.8
Total Assets	16.2	9.1	14.5	16.1
RWA	21.4	7.0	15.2	16.6
Customer deposits	16.1	11.7	15.9	17.1
Ratios (%)				
NIM	3.00	3.56	3.46	3.36
Gross yield	7.50	8.75	8.70	8.39
Cost of funds	4.98	5.69	5.65	5.38
Spread	2.51	3.07	3.04	3.01
NPL/gross loans	3.3	4.5	5.0	5.3
Credit cost	1.27	1.42	1.31	1.19
Coverage	51.2	60.1	58.0	58.0
NPL/RWA	2.3	3.4	3.9	4.1
Provision/RWA	1.2	2.1	2.2	2.4
Net write-off/RWA	-	-	-	-
NPL/NTE	39.0	47.3	55.0	60.4
Net loans/total assets	61.8	65.0	65.1	64.9
RWA/total assets	88.5	86.8	87.4	87.8
Loans/deposits	81.0	83.1	82.3	81.4
Avg IEA/avg total assets	95.3	95.1	94.7	94.3
Avg IBL/avg total liab	86.1	86.9	87.8	88.1
Cost/income	47.6	45.2	46.7	47.6
Non-int income/total income	32.7	24.9	25.6	24.5
ROAA (including goodwill)	0.73	0.91	0.91	0.88
ROAE (including goodwill)	12.6	15.7	14.7	14.6
Return on avg tier 1	9.9	11.8	11.0	11.2
Leverage (x)	17.4	17.2	16.1	16.6
Valuation data				
PE (diluted EPS)	14.9	10.8	10.0	9.0
P/PPOP	4.9	4.1	3.9	3.6
P/BVPS	1.9	1.6	1.4	1.2
P/NTE	1.9	1.6	1.4	1.2
Dividend yield (x)	1.5	1.8	2.1	2.5
P/Deposit	0.1	0.1	0.1	0.1
P/Asset	0.1	0.1	0.1	0.1

p=provisional figures



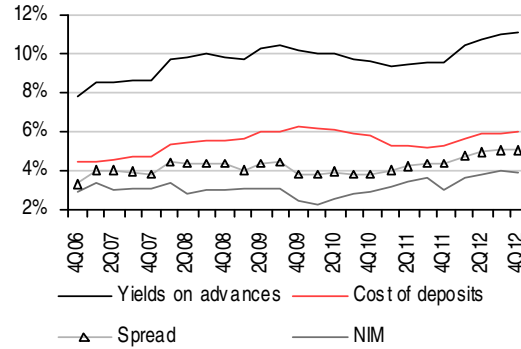
Note: price at close of 18 May 2012

SBI: Low cost deposit mix, NIMs



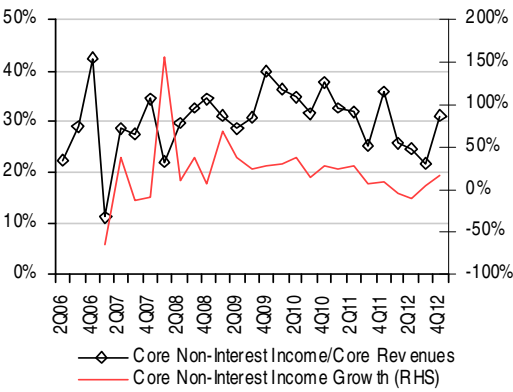
Source: Company data, HSBC

SBI: Margin Dynamics: higher yields driving higher margins



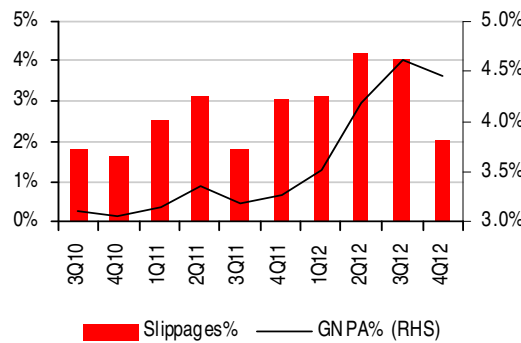
Source: Company data, HSBC

SBI: Core Non Interest Income trends



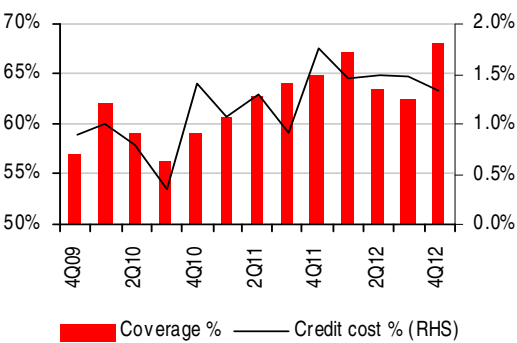
Source: Company data, HSBC

SBI: Slippages decline leading to lower Gross NPLs in 4Q



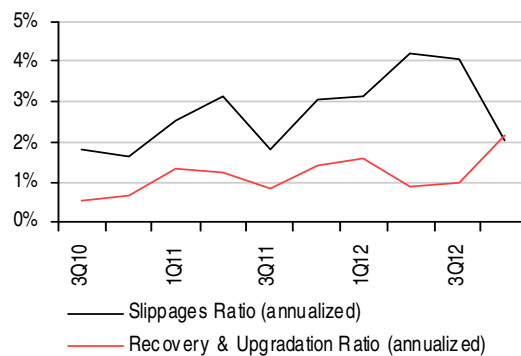
Source: Company data, HSBC

SBI: Marginal fall in credit cost and higher coverage ratio



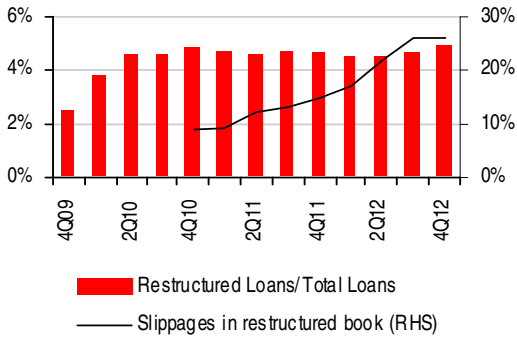
Source: Bloomberg, Company data, HSBC

SBI: Lower slippages and significant recoveries



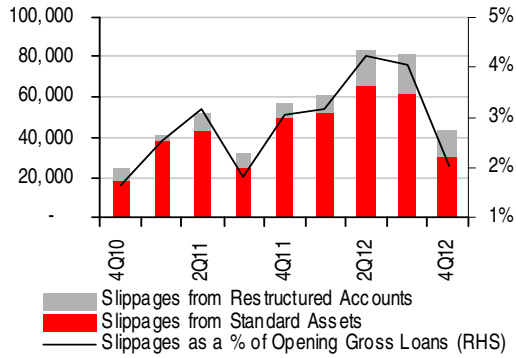
Source: Bloomberg, Company data, HSBC

SBI: Slippages in Restructured book



Source: Company data, HSBC

SBI: Slippages from Restructured & Standard assets (INRmn)



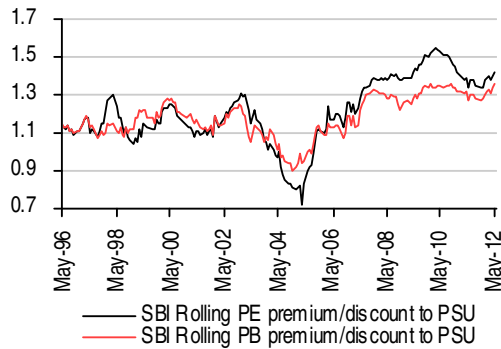
Source: Company data, HSBC

SBI: Advances Breakup and Growth

(INR bn)	Outstanding	Y-o-Y (%)	Q-o-Q (%)
International Advances	1,357	24%	1%
Retail Advances	1,824	11%	4%
SME Advances	1,392	16%	5%
Farm credit	1,169	23%	15%
Corporate Advances	2,927	10%	1%

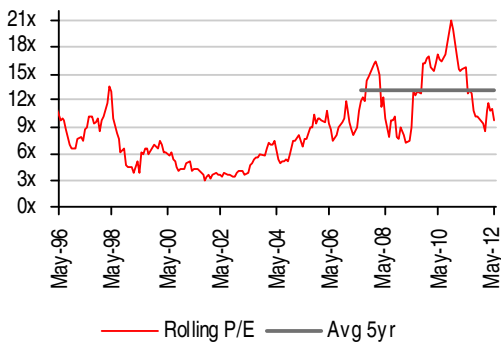
Source: Company data, HSBC

SBI: Rolling PE PB premium / discount to PSU



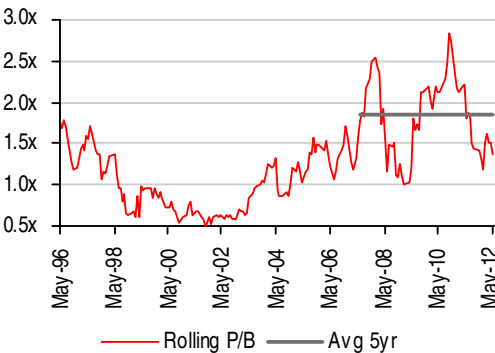
Source: Company data, HSBC

SBI: 12-months fwd Rolling PE



Source: Bloomberg, Company data, HSBC

SBI: 12-months fwd Rolling PB



Source: Bloomberg, Company data, HSBC

SBI: 4Q and FY12 results summary

(INR bn)	Q412	y-o-y %	q-o-q %	FY12	y-o-y %
Income Statement					
Interest income	286.96	32%	4%	1,065.21	31%
Interest on Advances	221.41	36%	6%	810.78	35%
Income on Investments	62.05	19%	-3%	238.85	22%
Interest on Balances with RBI & other inter bank funds	1.02	17%	-5%	4.14	1%
Other interest	2.48	55%	-1%	11.44	-16%
Interest expense	169.92	24%	5%	632.30	29%
Net interest income	117.04	45%	2%	432.91	33%
Other income - ex treasury	52.90	18%	64%	152.71	2%
Treasury gain	(0.26)	-108%	98%	(9.20)	-200%
Total other income	52.64	9%	148%	143.51	-9%
Operating income	169.68	32%	25%	576.43	19%
Core operating income	169.94	36%	16%	585.62	23%
Operating expense	73.71	8%	16%	260.69	13%
Employee expenses	54.31	29%	39%	169.74	17%
Operating profit	95.97	58%	32%	315.74	25%
Core operating profit	96.23	68%	15%	324.93	33%
Loan loss provisions	28.37	-13%	-6%	115.46	31%
Other provisions	3.03	-66%	151%	15.44	-3%
Total provisions	31.40	-24%	30%	130.90	26%
Pre tax profit	64.56	236%	33%	184.83	24%
Tax	24.06	27%	51%	67.76	1%
Net profit	40.50	19298%	24%	117.07	42%
Balance sheet					
	Q412	y-o-y %	q-o-q %	FY12	y-o-y %
Advances	8,676	15%	3%	8,676	15%
Deposits	10,436	12%	4%	10,436	12%
CASA mix	46.6%	(202) bps	(88)bps	47%	(202)bps
Gross NPLs	396.8	57%	-1%	397	57%
Net NPLs	158.2	28%	-16%	158	28%
Total Assets	13,355	9%	3%	13,355	9%
Average Total Assets	13,185	10%	4%	12,796	12%
Ratios					
	Q412	y-o-y % pnts	q-o-q % pnts	FY12	y-o-y % pnts
LDR	83.1	2.1	(1.4)	83.1	2.10
Incremental LDR	101.0	4.9	3.0	101.0	4.90
Margins (reported)	3.89	0.82	(0.16)	3.85	0.53
NII / Avg Deposits	4.58	1.0	(0.1)	4.4	0.64
Cost-income ratio	43.4	(9.3)	(3.1)	45.2	(2.38)
Core cost income ratio	43.4	(10.8)	0.2	44.5	(4.01)
LLP/Avg loans	1.32	(0.4)	(0.1)	1.4	0.16
Gross NPL ratio	4.44	1.2	(0.2)	4.44	1.16
Net NPL ratio	1.82	0.2	(0.4)	1.82	0.19
Coverage ratio	60.1	8.9	7.0	60.1	8.88
Coverage ratio (RBI guidelines)	68.1	3.1	5.6	68.1	3.15
Tier 1 ratio	9.8	2.0	2.2	9.8	2.02
Total CAR	13.9	1.9	2.3	13.9	1.88
Effective tax rate	37.3	(61.6)	4.5	36.7	(8.07)
Tax/Operating Profit	25.1	(6.2)	3.2	21.5	(4.94)
ROA	1.15	1.1	0.2	0.9	0.17

Source: Company data, HSBC

SBI: Earnings outlook

(INRm)	FY13e	y-o-y %	FY14e	y-o-y %
Income Statement				
Interest Income	1,179,462	10.7%	1,306,578	10.8%
Interest Expenses	710,676	12.4%	783,229	10.2%
Net Interest Income (NII)	468,786	8.3%	523,349	11.6%
P/(L) on sale of Investments	2,299	-125.0%	2,759	20.0%
P/(L) on Exchange Transactions	15,002	4.8%	15,714	4.7%
Fee & Other Income	144,386	4.3%	151,409	4.9%
Non-interest income ex-treasury	159,388	4.4%	167,124	4.9%
Total Non-Interest Income	161,687	12.7%	169,883	5.1%
Total Income	630,474	9.4%	693,232	10.0%
Operating Expenses	294,740	13.1%	330,284	12.1%
Pre-provisioning Profits	335,733	6.3%	362,949	8.1%
Provisions for NPAs	122,039	5.7%	127,503	4.5%
Total Provisions	134,894	3.0%	139,527	3.4%
PBT	200,839	8.7%	223,421	11.2%
Tax	70,294	3.7%	78,197	11.2%
PAT	130,545	11.5%	145,224	11.2%
Balance Sheet				
		y-o-y %		y-o-y %
Deposits	12,097,633	15.9%	14,164,608	17.1%
Net Advances	9,951,907	14.7%	11,525,259	15.8%
Total Assets	15,288,119	14.5%	17,746,026	16.1%
BPS	1,399.00	11.8%	1,559.50	11.5%
EPS	194.54	8.5%	216.42	11.2%
Ratios				
		y-o-y %pnts		y-o-y %pnts
Net Interest Margin	3.5%	(0.10)	3.4%	(0.10)
ROA	0.9%	(0.00)	0.9%	(0.03)
ROE	14.7%	(1.04)	14.6%	(0.05)
Tax rate	35.0%	(1.66)	35.0%	-
Cost Income	46.7%	1.52	47.6%	0.89
Core Cost Income	46.9%	2.41	47.8%	0.91

Source: Company data, HSBC estimates

SBI: Estimates Changes

(INRm)	FY13e	Change	FY14e	Change
Income Statement				
Interest Income	1,179,462	-1.7%	1,306,578	-2.8%
Interest Expenses	710,676	0.2%	783,229	-1.8%
Net Interest Income (NII)	468,786	-4.4%	523,349	-4.2%
Non-interest income ex-treasury	159,388	5.1%	167,124	-3.4%
Total Non-Interest Income	161,687	3.1%	169,883	-4.9%
Total Income	630,474	-2.6%	693,232	-4.4%
Operating Expenses	294,740	-0.4%	330,284	-0.1%
Pre-provisioning Profits	335,733	-4.4%	362,949	-8.0%
Provisions for NPAs	122,039	-7.3%	127,503	-2.8%
Total Provisions	134,894	-8.0%	139,527	-3.8%
PBT	200,839	-1.9%	223,421	-10.4%
Tax	70,294	1.0%	78,197	-7.8%
PAT	130,545	-3.3%	145,224	-11.8%
Balance Sheet				
Deposits	12,097,633	-3.7%	14,164,608	-3.7%
Net Advances	9,951,907	-1.1%	11,525,259	-1.2%
Total Assets	15,288,119	-5.2%	17,746,026	-4.8%
BPS	1,399.00	3.0%	1,559.50	0.9%
EPS	194.54	-2.8%	216.42	-11.3%
Ratios				
Net Interest Margin	3.5%	0.03	3.4%	0.02
ROA	0.9%	0.02	0.9%	-0.07
ROE	14.7%	-0.95	14.6%	-2.18
Tax rate	35.0%	1.00	35.0%	1.00
Cost Income	46.7%	1.03	47.6%	2.04
Core Cost Income	46.9%	0.84	47.8%	1.87

Source: Company data, HSBC estimates

Valuation and risks

Underweight, Target price INR2,000

We continue to value SBI using a weighted average combination of PE, PB, and economic profit model (EPM) methodologies. We assign a 20%, 50% and 30% weight each to the PE, PB and EPM components respectively.

The three-stage EPM uses explicit forecasts until FY14e, followed by 10 years of semi-explicit forecasts. The final stage of 12 years (fade period) assumes convergence of ROE and COE. EPM is based on the assumptions in the following table:

SBI: EPM assumptions

Semi-explicit forecasts for 10 yrs

Loan CAGR	8%
Dividend payout	20%
Fade period of 12 yrs	
Risk free rate	8%
Beta	1.0
Equity risk premium	6%
Cost of Equity	14%
EPM value of Bank	1,289
EPM value of Subsidiaries	472
Total EPM value (including subsidiaries)	1,761

Source: HSBC estimates

SBI: Sum-of-parts valuation (INRm)

	Stake	Value to SBI	Value/share	Remarks
SBI associate banks		238,298	317	1.1x FY13e PB
SBI Life	74%	178,718	197	14% NBAP margins and 14x new business multiple
SBI AMC	63%	21,252	20	4% of AUM
SBI Capital markets	86%	18,816	24	10x FY13e earnings
SBI DFHI	67%	4,568	5	10x FY13e earnings
SBI Cards	60%	5,295	5	10x FY13e earnings
Total value of Subsidiaries			568	
Less: Cost of investment			96	
EPM value of Subsidiaries			472	

Source: Company data, HSBC estimates

We are retaining our 12-month target price at INR2,000; see also the tables below.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%, or 6-16% above the current share price. Our target price implies a potential return of 4.8%, including dividend yield, which is below the Neutral band; therefore, we retain our Underweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

SBI: Valuations summary (INR)

	PE multiple	PE-based TP	PB multiple	PB-based TP	DCF value	Weighted Target Price
New	9.3x	2,013	1.4x	2,138	1,761	2,000
Old	9.3x	2,168	1.4x	2,061	1,786	2,000

Source: HSBC

Upside risks: Upturn in economic cycle; asset quality improves

Disclosure appendix

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Important disclosures

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

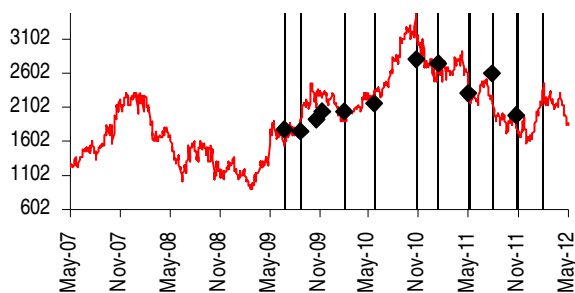
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Neutral (Hold)	38%	(25% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(16% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

State Bank of India (SBI.NS) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	12 July 2009
Neutral (V)	Underweight (V)	09 September 2009
Underweight (V)	Neutral (V)	19 February 2010
Neutral (V)	Underweight (V)	10 June 2010
Underweight (V)	Underweight	09 November 2010
Underweight	Neutral	24 January 2011
Neutral	Underweight	18 May 2011
Underweight	Overweight	15 August 2011
Overweight	Neutral	10 November 2011
Neutral	Underweight	14 February 2012
Target Price	Value	Date
Price 1	1780.00	12 July 2009
Price 2	1751.00	09 September 2009
Price 3	1923.00	02 November 2009
Price 4	2038.00	27 November 2009
Price 5	2033.00	19 February 2010
Price 6	2169.00	10 June 2010
Price 7	2800.00	09 November 2010
Price 8	2740.00	24 January 2011
Price 9	2306.00	18 May 2011
Price 10	2600.00	15 August 2011
Price 11	2000.00	10 November 2011

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
STATE BANK OF INDIA	SBI.NS	1848.35	17-May-2012	1,2,4,5,6,7,11

Source: HSBC

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