

State Bank of India Ltd (SBI)

BUY

Still some meat left

Current price: Rs1,080

Table 1: Valuation (Rs mn)

Year ended	Net Interest Income	Other Income	Net Profit	EPS (Rs)	EPS growth (%)	P/E (x)	P/BV (x)	RoE (%)	RoA (%)	DPS (Rs)
FY07	150,582	67,653	45,488	86.4	-	10.1	1.5	15.4	0.9	14.0
FY08	170,212	86,839	67,291	106.5	23	15.0	2.1	16.8	1.0	21.5
FY09E	214,947	115,768	87,757	138.9	30	7.8	1.2	16.7	1.1	31.0
FY10E	273,424	118,361	92,845	147.0	6	7.3	1.1	15.6	0.9	35.0

Source: Brics Research

Major shareholder: Promoters: 59.4%
Public: 40.6%
Others: LIC 4.5%, CLSA Mauritius 2.65%
TCI Cyprus 1.4%

Issued Capital: Rs634.8mn shares of Rs10 each

SBI's Q3FY09 net interest income (NII) at Rs57.5bn increased 35% yoy, driven by average asset growth of 29% and NIM of 3.15%. Fee-based income at Rs16bn increased 57% yoy led by growth in corporate and retail segments. Treasury profits increased 5% yoy to Rs6.7bn. Asset quality remained healthy on change in provisioning norms made by the RBI, due to which NPA cycles of banks have been delayed. Payment to employees at Rs30.4bn increased 38% yoy mainly on account of additional provision of Rs7.5bn under the AS-15 policy for pension liabilities.

At the current price of Rs1,080, the stock trades at P/E of 7.8x FY09E earnings and 1.2x FY09E book value. We value SBI's core business at Rs1,052 using DDM. Valuation of subsidiaries at Rs200 implies a fair price of Rs1,252 - 16% upside from current levels. Recommend BUY.

Key Highlights

- **NII up 35% yoy - Margins above our expectations**
NII at Rs57.5bn increased 35% yoy led by assets growth of 29%. Interest income increased 43%, and interest expenses increased 46% yoy. NIMs at 3.15% improved 14 bps yoy, clearly indicating SBI's ability to pass on any

increase in cost of funds to borrowers. Going forward, we expect SBI to maintain NIMs at ~3%.

- **Fee-based income up 57%, treasury profits up 5% yoy**
Fee-based income at Rs16bn increased 57% yoy led by overall growth in corporate and retail segments. SBI's strategy of focusing heavily on fee-based products has started to pay off. Though growth in fee-based income is expected to slow down going forward, we estimate 10% growth in FY10E.

Profit on sale of investments increased 5% yoy to Rs6.7bn. Investment depreciation of Rs3.4bn reversed during the quarter, taking the total gain to Rs10.1bn, which was below our estimates of Rs25bn.

- **Portfolio quality remained healthy -Is it sustainable?**

Table 2: Movement in NPAs (Rs mn)

	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09
Gross NPAs	111,830	135,990	114,080	125,520	133,140
Gross NPA (%)	2.8	3.2	2.5	2.5	2.6
Net NPAs	56,100	74,240	62,980	66,180	68,640
Net NPA (%)	1.4	1.8	1.4	1.3	1.4

Source: Brics Research

NPAs have started to rise though at much slower pace compared to our estimates. The key reason for NPAs falling in Q1FY09 can be attributed to the agriculture loan waiver, for which SBI had a total exposure of Rs55bn. Changes made by the RBI in Q3FY09 has delayed the NPA cycle, as restructuring has been allowed without classifying the loans as NPAs. We estimate gross NPAs to rise to ~Rs190bn in FY09E and ~Rs250-260bn in FY10E due to slowing economy.

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- **Net profits increase 37% yoy**

Employee expenses at Rs30bn were up 39% yoy due to additional provision of Rs7.5bn towards pension liability under AS-15 policy. Cost/income ratio declined by 439 bps from 51.7% to 47.3%. Net profits at Rs24.7bn increased 37% yoy. ROA at 1.02% was down 2 bps yoy, and ROE at 14.1% was down 389bps yoy largely on account of equity capital raised during FY08.

- **Deposits - Gaining market share at expense of Private sector banks**

Table 3: Growth in Deposits (Rs mn)

	Q3FY08	Q3FY09	yoy (%)
Current	490,340	515,080	5.0
Saving	1,467,620	1,857,990	26.6
CASA	1,957,960	2,373,070	21.2
CASA (%)	38.0	34.0	
Term	3,143,360	4,556,140	44.9
Total	5,101,320	6,929,210	35.8

Source: Brics Research

SBI's market share in domestic deposits has increased by ~200bps to 17.5% vis-à-vis 15.4% in Q3FY08, clearly indicating the shift in depositors' preference towards state-owned banks. CASA ratio is down yoy, as high interest rates make customers shift deposits from current and saving accounts to term deposits. We estimate that SBI should be able to maintain its current market share in FY10E.

Valuations

At the current price of Rs1,080, the stock trades at P/E of 7.8x FY09E earnings and 1.2x FY09E book value. We value SBI's core business at Rs1,052 using DDM. Valuation of subsidiaries at Rs200 implies a fair price of Rs1,252, which represents 16% upside from current levels.

We continue to remain confident on SBI due to (i) Shift in depositors' preference towards state-owned banks, which will help SBI gain market share (ii) Conservative lending, which has aided SBI to maintain ROEs of ~15-16% with limited NPAs (~1.5%). Recommend BUY.

Table 4: Key concerns for the sector - Fast growth of state-owned banks (%)

Bank Group	Annual Growth (yoy) as on 4th January 2008	Annual Growth (yoy) as on 2nd January 2009
DEPOSITS		
State-owned Banks	24.2	24.2
Foreign Banks	34.1	12.1
Private Sector Banks	26.9	13.4
Scheduled Commercial Banks	25.1	21.2
CREDIT		
State-owned Banks	19.8	28.6
Foreign Banks	30.7	16.9
Private Sector Banks	24.2	11.8
Scheduled Commercial Banks	21.4	24.0

Source: RBI

State-owned banks' credit off-take (~29%) has been much higher than that of private sector banks (~12%) in FY09. Even though the same has been matched by (~24%) growth in deposits, the growth seems abnormally high in the current credit environment. We are of the view that excessive credit growth currently will lead to very high NPAs, going forward, for state-owned banks.

Most private sector banks have consciously been growing slowly, as they are uncomfortable with credit quality of borrowers.

NPAs of most banks have not risen significantly due to changes made in provisioning norms, wherein the NPA cycle has been delayed for few months. We reckon that NPAs will rise much faster for loans sanctioned in FY09.

Lately state-owned banks have started lending aggressively to risky sectors such as commercial real estate, wherein a large part of funds raised from mutual funds have been retired with loans from state-owned banks.

Till date, we have been bullish on state-owned banks. However, due to concerns mentioned above, the risk-reward ratio is slightly turning positive for private sector banks, as valuations have become attractive. We are not upgrading our rating on the private sector banks to BUY. However, we recommend increasing the weightage of private sector banks in the banking space.

Table 3: Valuations*

	CMP (Rs)	Mkt Cap (Rs mn)	Avg Vol (Nos)	PE (x)			ROE (%)			PB (x)			ROA (%)		
				FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
State Bank India	1,114	707,129	4,325,155	15.0	7.8	7.3	16.8	16.7	15.6	2.1	1.2	1.1	1.0	1.1	0.9
ICICI Bank Ltd	411	457,457	15,449,760	12.8	11.5	10.2	9.9	8.4	8.8	1.0	0.9	0.9	0.8	1.0	1.1
HDFC Bank Ltd	916	389,596	2,286,211	19.8	16.6	13.7	17.7	16.5	17.0	2.8	2.5	2.1	1.4	1.3	1.5
Kotak Mahindra	278	96,055	2,671,536	9.4	13.6	12.3	21.7	10.6	10.7	1.6	1.5	1.3	2.9	1.5	1.4
Bank of Baroda	244	88,790	1,423,764	5.7	5.3	4.7	15.3	15.4	16.0	0.8	0.8	0.7	0.9	0.8	0.8
Bank of India	241	126,436	3,342,902	6.1	4.7	4.2	23.5	25.6	22.9	1.2	1.1	0.9	1.2	1.4	1.3
Punjab National Bank	395	124,387	1,101,486	5.7	5.2	4.5	18.3	19.4	19.2	1.0	0.9	0.8	1.2	1.1	1.1

* Bloomberg consensus estimates

Table 4: Quarterly results

Period Ending							(Rs mn)	
	31-Dec-07	31-Mar-08	30-Jun-08	30-Sep-08	31-Dec-08	yoy (%)	qoq (%)	
Interest on Advance	92,710.5	96,034.7	100,139.9	114,820.8	128,366.2	38.5	11.8	
Income on Investment	32,711.1	32,117.6	35,079.4	38,287.0	40,065.8	22.5	4.6	
Interest on Balances	926.1	2,188.0	2,070.7	2,018.1	1,737.7	87.6	-13.9	
Others Interests	320.4	5,427.0	702.0	539.1	10,133.7	3,062.8	1,779.7	
Interest Income	126,668.1	135,767.3	137,992.0	155,665.0	180,303.4	42.3	15.8	
Interest Expended	-84,104.5	-87,761.4	-89,815.4	-101,111.5	-122,721.5	45.9	21.4	
Net Interest Income	42,563.6	48,005.9	48,176.6	54,553.5	57,581.9	35.3	5.6	
NIM (%)	3.0				3.2			
Other Income	26,971.9	28,172.0	24,038.7	23,431.4	32,255.6	19.6	37.7	
Total Income	69,535.5	76,177.9	72,215.3	77,984.9	89,837.5	29.2	15.2	
Payment/Provisions for Employees	-21,946.8	-15,696.0	-21,309.5	-22,212.0	-30,455.6	38.8	37.1	
Other Operating expenses	-10,991.3	-16,750.6	-11,282.4	-13,840.8	-14,555.6	32.4	5.2	
Total Operating Expenses	-32,938.1	-32,446.6	-32,591.9	-36,052.8	-45,011.2	36.7	24.8	
Profit before Tax	36,597.4	43,731.3	39,623.4	41,932.1	44,826.3	22.5	6.9	
Tax	-10,466.7	-8,707.4	-7,720.8	-13,228.8	-18,073.7	72.7	36.6	
Provisions and Contingencies	-8,044.3	-16,191.4	-15,494.7	-6,106.1	-1,968.3	-75.5	-67.8	
Net Profit	18,086.4	18,832.5	16,407.9	22,597.2	24,784.2	37.0	9.7	
Equity Capital	5,263.0	6,314.7	6,348.8	6,348.8	6,348.8	20.6	-	
Capital Adequacy Ratio in Percent	12.3	13.5	13.0	12.1	-			
Basic And Diluted EPS after Extraordinary item	34.4	34.7	25.9	35.6	39.0			

Source: Brics Research

Income Statement		(Rs mn)				
Year ended 31 March	FY06	FY07	FY08	FY09E	FY10E	
Interest income	357,949	372,423	489,503	678,958	871,780	
- on advances	176,963	248,392	352,281	496,058	630,857	
- on investments	139,775	104,562	119,442	175,682	233,788	
- on RBI/bank balances	17,610	17,290	12,001	1,265	1,003	
- on others	23,601	2,179	5,780	5,953	6,132	
Interest expense	(201,593)	(221,841)	(319,291)	(464,012)	(598,355)	
Net interest income	156,356	150,582	170,212	214,947	273,424	
Non-interest income	73,887	67,653	86,839	115,768	118,361	
Fee/Commission income	39,962	48,045	59,143	73,928	81,321	
Other operating income	28,053	20,337	18,233	28,840	32,040	
Trading gains/(losses)	5,872	(729)	9,463	13,000	5,000	
Operating income	230,243	218,235	257,051	330,715	391,786	
Core operating income	224,371	218,964	247,588	317,715	386,786	
Operating expenses	(117,251)	(118,235)	(126,086)	(156,452)	(176,486)	
Employee expenses	(81,230)	(79,326)	(77,859)	(97,323)	(109,002)	
Administrative expenses	(28,729)	(32,885)	(41,428)	(51,784)	(59,552)	
Depreciation	(7,291)	(6,024)	(6,800)	(7,344)	(7,931)	
Operating profit	112,992	99,999	130,965	174,263	215,300	
Provision Charges	(43,931)	(23,749)	(26,687)	(37,143)	(70,230)	
Bad and doubtful debts charge	(1,478)	(14,283)	(20,009)	(23,964)	(60,952)	
Other provisions	(42,453)	(9,466)	(6,677)	(13,178)	(9,278)	
Profit before tax and exceptionals	69,061	76,251	104,279	137,121	145,070	
Exceptionals	19	75	110	0	0	
Profit before tax	69,081	76,325	104,389	137,121	145,070	
Tax provided	(24,995)	(30,838)	(37,098)	(49,364)	(52,225)	
Net profit	44,086	45,488	67,291	87,757	92,845	
Adjusted profit	40,339	48,183	56,656	79,437	89,645	

Balance Sheet		(Rs mn)				
Year ended 31 March	FY06	FY07	FY08	FY09E	FY10E	
Cash	20,802	25,301	32,203	60,277	144,680	
Balances with RBI	195,725	265,463	483,143	392,004	490,506	
Balances with other banks	229,073	228,923	159,317	183,215	201,536	
Net advances	2,616,415	3,373,365	4,167,682	5,417,987	6,772,483	
Retail assets	610,670	735,960	751,380	0	0	
Agriculture assets						
Investments	1,625,342	1,491,489	1,895,013	2,890,695	3,440,925	
Investments in government securities	1,381,792	1,210,462	1,434,723	2,384,943	2,884,870	
Other investments	243,550	281,027	460,290	505,753	556,055	
Other interest earning assets						
Interest earning assets	4,687,358	5,384,541	6,737,358	8,944,177	11,050,130	
Fixed assets	27,529	28,189	33,735	40,482	46,554	
Other assets	223,808	252,923	444,170	510,796	561,875	
Total assets	4,938,696	5,665,652	7,215,263	9,495,455	11,658,559	
Deposits from banks	121,966	155,883	193,789	203,478	213,652	
Deposits from customers	3,678,495	4,199,328	5,180,251	7,127,342	8,918,282	
Demand deposits	404,634	710,232	858,201	1,029,841	1,184,318	
Savings deposits	1,191,832	1,291,365	1,542,293	1,927,866	2,313,439	
Time deposits	2,082,028	2,197,731	2,779,756	4,169,635	5,420,525	
Borrowings	306,412	397,033	517,274	594,865	684,095	
Other interest bearing liabilities	49,858	161,695	212,893	266,117	319,340	
Interest bearing liabilities	4,156,731	4,913,939	6,104,207	8,191,803	10,135,369	
Other liabilities	505,524	438,728	620,730	744,876	893,851	
Total liabilities	4,662,255	5,352,667	6,724,937	8,936,678	11,029,220	
Shareholders funds	276,441	312,985	490,326	558,777	629,339	
Capital	5,263	5,263	6,315	6,315	6,315	
Reserves and surpluses	271,178	307,722	484,012	552,462	623,024	
Total liabilities and equity	4,938,696	5,665,652	7,215,263	9,495,455	11,658,559	

Year ended 31 March	FY06	FY07	FY08	FY09E	FY10E
Basic data					
No. of shares outstanding	526	526	631	631	631
Avg. no. of shares outstanding	526	526	631	631	631
Market capitalisation					
Per share data					
EPS	83.8	86.4	106.6	139.0	147.0
Adj. EPS	76.6	91.5	89.7	125.8	142.0
DPS	14.0	14.0	21.5	30.6	35.3
BVPS	525	595	776	885	997
Profitability					
RoE	17.0%	15.4%	16.8%	16.7%	15.6%
Adj. RoE	9.3%	16.3%	14.1%	15.1%	15.1%
RoA	0.9%	0.9%	1.0%	1.1%	0.9%
Adj. RoA	0.5%	0.9%	0.9%	1.0%	0.8%
Growth ratios					
Operating income growth	9.3%	-5.2%	17.8%	28.7%	18.5%
Core operating income growth	16.3%	-2.4%	13.1%	28.3%	21.7%
Operating cost growth	16.4%	0.8%	6.6%	24.1%	12.8%
Operating profit growth	2.8%	-11.5%	31.0%	33.1%	23.5%
Net profit growth	2.4%	3.2%	47.9%	30.4%	5.8%
EPS growth	2.4%	3.2%	23.3%	30.4%	5.8%
Adj. EPS growth	28.8%	19.4%	-2.0%	40.2%	12.8%
BVPS growth	14.8%	13.2%	30.6%	14.0%	12.6%
Advances Growth	29.3%	28.9%	23.5%	30.0%	25.0%
Yields					
Yield on advances	7.8%	8.3%	9.3%	10.4%	10.4%
Yield on investments	7.8%	6.7%	7.1%	7.3%	7.4%
Yield on interest earning assets	7.9%	7.4%	8.1%	8.7%	8.7%
Cost of deposits	5.1%	4.6%	5.8%	6.1%	6.1%
Cost of liabilities	5.0%	4.9%	5.8%	6.5%	6.5%
NIM	2.9%	3.0%	2.8%	2.7%	2.7%
Interest spread	2.9%	2.5%	2.3%	2.2%	2.2%
Efficiency ratios					
Cost-income ratio	50.9%	54.2%	49.1%	47.3%	45.0%
Core cost-income ratio	52.3%	54.0%	50.9%	49.2%	45.6%
Staff costs to total costs	69.3%	67.1%	61.8%	62.2%	61.8%
Operating costs to assets	2.5%	2.2%	2.0%	1.9%	1.7%
Assets per employee	25	31	40	50	58

Year ended 31 March	FY06	FY07	FY08	FY09E	FY10E
Dupont analysis					
Net interest income	3.3%	2.8%	2.6%	2.6%	2.6%
Non-interest income	1.5%	1.3%	1.3%	1.4%	1.1%
Trading profit	0.1%	0.0%	0.1%	0.2%	0.0%
Operating income	0.0%	0.0%	4.9%	0.0%	0.0%
Operating costs	-2.5%	-2.2%	-2.0%	-1.9%	-1.7%
Pre-provision profits	2.4%	1.9%	2.0%	2.1%	2.0%
Provisions	-0.9%	-0.4%	-0.4%	-0.4%	-0.7%
Bad debt provisions	0.0%	-0.3%	-0.3%	-0.3%	-0.6%
Other provisions	-0.9%	-0.2%	-0.1%	-0.2%	-0.1%
PBT	1.4%	1.4%	1.6%	1.6%	1.4%
Tax	-0.5%	-0.6%	-0.6%	-0.6%	-0.5%
ROA	0.9%	0.9%	1.0%	1.1%	0.9%
Leverage	18.44	17.99	16.03	15.93	17.80
ROE	17.0%	15.4%	16.8%	16.7%	15.6%
Asset quality					
Gross NPLs	103,758	99,980	128,370	190,677	269,915
Net NPLs	49,064	52,577	74,243	112,586	130,872
Gross NPLs (%)	4.0%	3.0%	3.1%	3.5%	4.0%
Net NPLs (%)	1.9%	1.6%	1.8%	2.1%	1.9%
PL provisions/avg. loans	0.1%	0.5%	0.5%	0.5%	1.0%
Inc. NPA/avg. loans	0.5%	0.6%	1.9%	1.3%	1.3%

Valuations

Year ended 31 March	FY06	FY07	FY08	FY09E	FY10E
P/E	12.4	12.0	9.8	7.5	7.1
P/Adj. E	13.6	11.4	11.6	8.3	7.3
P/BV	2.0	1.7	1.3	1.2	1.0
Dividend yield	1.3	1.3	2.1	2.9	3.4

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