Indiabulls

STATE BANK OF INDIA RESEARCH

EQUITY RESEARCH November 10, 2008

RESULTS REVIEW

Share Data

Market Cap	Rs. 826.3 bn
Price	Rs. 1,301.6
BSE Sensex	10,536.2
Reuters	SBI.BO
Bloomberg	SBIN IN
Avg. Volume (52 Week)	0.58 mn
52-Week High/Low	Rs. 2,540 / 991.10
Shares Outstanding	634.9 mn

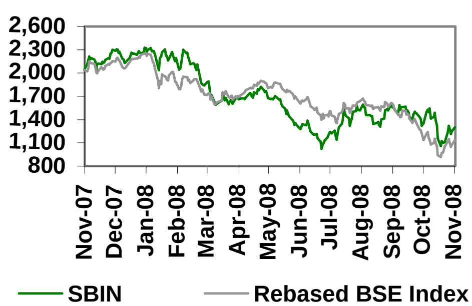
Valuation Ratios

Year to 31 March	2009E	2010E
EPS (Rs.)	116.8	128.9
+/- (%)	9.6%	10.4%
PER (x)	10.7x	9.7x
P / PPP (x)	5.3x	4.7x
P / ABV (x)	1.4x	1.3x

Shareholding Pattern (%)

Promoter	59
FIIs	12
Institutions	13
Public & Others	16

Relative Performance



State Bank of India — Buy

On firm ground

State Bank of India's operating profit and net profit for Q2'09 surged 54.5% and 40.2% yoy, respectively, exhibiting a strong performance. While we expect the economic slowdown to adversely impact the Bank's performance in the near-to-medium term, we believe that most of the negatives have been factored in the current price. At the current market price of Rs. 1,301.55, the stock is available at a discount of 18.4% to our fair value estimate of Rs.1,541. We, therefore, upgrade our rating to **BUY**.

Advances growth to slow down: SBI recorded a handsome 37% yoy growth in advances, translating into an 18% sequential growth in the first half. However, this momentum is likely to decelerate considerably in the second half of 2008-09. We expect advances to grow by 6.5–8.5% sequentially in the second half, translating into a yoy growth of 26–28% for 2008-09. For 2009–10, we expect advances growth to fall further to 20%, before picking up in 2010–11.

CASA likely to deteriorate in the near-to-medium term: We expect the deposit growth to remain robust over the next few quarters, primarily due to a shift of funds from the money market mutual funds and private banks. We expect a bulk of these deposits to move to term deposits at state-run banks due to heightened risk aversion amongst depositors. This, in turn, is likely to adversely impact the CASA ratio in the medium term. Thus, we expect the CASA ratio to drop by about 4 percentage points in FY09.

NIM to come under pressure: We expect the Bank's NIM to contract by 10 bps for FY09, owing to a decline in the spread and a fall in CASA. The Bank has cut its PLR by 75 bps and its deposit rates by 50 bps, which has compressed the spread. Also, the high-cost deposit base mobilised in the past two months is unlikely to be re-priced soon, further pressuring the NIM.

Key Figures (Standalone)

Quarterly Data	Q2'08	Q1'09	Q2'09	YoY %	QoQ%	FY07	FY08	YoY %
(Figures in Rs. mn, except per share data)								
Net Interest Income	37,629	48,177	54,554	45.0%	13.2%	150,582	170,212	13.0%
Net Operating Income	58,049	72,215	77,985	34.3%	8.0%	218,235	257,162	17.8%
Pre-Prov Profit	27,132	39,623	41,932	54.5%	5.8%	99,999	131,076	31.1%
Net Profit	16,114	16,408	22,597	40.2%	37.7%	45,413	67,291	48.2%
Cost/Operating Income(	54.5%	45.1%	45.7%	-	-	54.2%	49.0%	-
Net Interest Margin	3.0%	3.0%	3.2%	-	-	3.1%	3.1%	-
NPA ratio	1.6%	1.4%	1.3%	-	-	1.6%	1.8%	-
Per Share Data (Rs.)								
PPP per share	51.6	62.4	66.0	28.1%	5.8%	189.6	207.6	9.5%
EPS	30.6	25.9	35.6	16.6%	37.4%	86.1	106.6	23.8%
BVPS	647.3	798.2	833.8	28.8%	4.5%	594.7	776.5	30.6%

Result Highlights

Robust rise in deposits: State Bank of India's deposit base surged 28% yoy and its CASA ratio improved from 39.45% to 39.71% over the same period. On a quarterly basis, the bank's deposits grew by 10.3%. Most of the increase over the previous quarter was recorded in term deposits, owing to the high deposit rates offered by the Bank (due to the then prevailing tight liquidity conditions). This led to a decline in CASA from 41.87% in Q1'09 to 39.71% this quarter.

Improvement in the credit-deposit ratio: The Bank's credit-deposit ratio increased from 68.9% in Q2'08 to 73.8% this quarter. This was following a robust 37% yoy increase in advances, which exceeded the 28% growth in deposits over the same period.

Increase in the NII and NIM: SBI's net interest income (NII) increased by 45% yoy to reach Rs. 54.6 bn. Following this, the NIM increased on a yoy basis, from 3.01% to 3.16%. The increase in the NIM was on account of a rise in the credit-deposit ratio from 68.9% to 73.8% over the same period, despite a 6-bps decline in the interest rate spread. On a quarterly basis, however, a rise in the average spread resulted in a 13.2% increase in the NII. Therefore, the NIM rose from 3.03% to 3.16% on a quarterly basis.

Modest growth in Other Income: The Bank's other income rose by 14.8% yoy but declined by 2.5% over the previous quarter. Core fee income comprised 57% of the non-interest income during this quarter and rose by 41% yoy.

Profit growth driven by core business: The operating profit increased by 54.5% yoy, given a robust increase in the NII and a modest rise in the non-interest income. Net profit rose by 40.2% yoy after accounting for a 30% increase in the tax paid.

Profitability: The Bank's ROE declined from 17.38% for H1'08 to 14.63% for H1'09. The return on assets (annualised), however, increased from 0.99% in Q2'08 to 1.13% in Q2'09.

Increase in provision cover: The Bank increased its coverage ratio from 44.8% in Q1'09 to 47% this quarter, following a sharp 10% increase in the gross NPAs over the same period. This increase, in our view, resulted from the deterioration in the loan book owing to a slowing economy. On a yoy basis, however, the asset quality improved—the gross NPA ratio declined from 3.07% in Q2'08 to 2.51% in Q2'09.

Capital adequacy: The Bank's total capital adequacy ratio for Q2'09 stood at 11.51% as against the regulatory minimum of 9%. Out of this, the Tier I capital adequacy ratio was 8.22%, over and above the regulatory minimum of 6%.

Outlook

Deposit growth to be robust, decline in CASA anticipated: We expect the Bank's deposit growth to be 27% for FY09 (as against 23% in FY08). This is because a pervasive, weak investor sentiment is driving funds out of the capital markets towards safer, fixed-income instruments/term deposits. Also, funds moving out of the money-market mutual funds are likely to move towards short-term, low-cost deposits offering similar return and liquidity. Moreover, public sector banks are likely to be the largest beneficiaries of the movement of funds towards deposits as they are perceived to be safer than the private sector banks. Therefore, we expect the growth in term deposits to outpace the growth in CASA, leading to a deterioration in the CASA ratio. For FY10, we expect the deposit growth to slow down to 22%, owing to the impact of a weakening economy.

Advances to slow down: The Bank's advances have grown by 18% during H1'09 over FY08. For the second half, we expect the growth to slow down to 6.5–8.5%, resulting in an annual growth of 26–28% for FY09. We expect this trend to continue during FY10 due to the second-round effects of the liquidity crisis on the real economy. In FY10, we expect the advances to grow by 20%.

NIM to remain under strain: We expect the Bank's NIM to come under pressure owing to an anticipated decline in the spread, a fall in the CASA ratio, and a rise in the investment-deposit ratio. The Bank has reduced its PLR by 75 bps (wef 10th November, 2008) and deposit rates by 50 bps (wef from December 1, 2008). This will lead to a contraction in the

Bank's interest-rate spread. In addition, the Bank has mobilised a high-cost deposit base during the past 2 months, which, unlike loans, is not likely to be re-priced soon. With an expectation of a decline in the CASA ratio, the average cost of funds is likely to increase further. Finally, an anticipated rise in the investment-deposit ratio in a falling interest rate environment is likely to lead to a decline in the average yield for the Bank. These factors are likely to put downward pressure on the NIM.

Core Other Income growth to decline: With the expected slowdown in the advances growth over the next few quarters, the growth in fee and commission income is also expected to decline.

Asset quality to deteriorate, but not significantly: Given the weakening economy, the Bank's asset quality is likely to deteriorate. It has increased its coverage ratio from 44.8% to 47% qoq, which could be in anticipation of increased delinquencies for the next few quarters. However, the Bank has a modest amount of direct exposure to sensitive sectors such as the real estate and capital markets. It also has a well-diversified loan book and is not aggressively focused on any particular segment. This gives us confidence that SBI's asset quality will not undergo a significant deterioration.

AUM growth likely to slow down: Given a weak investor sentiment and the erosion in the value of capital markets, growth in the assets under management of SBI Mutual Fund and SBI Life is likely to decelerate.

Valuation

Our fair value estimate of Rs. 1,541 for SBI is based on the Sum-Of-The-Parts valuation methodology. We have arrived at a target P/B multiple of 1.4x for the standalone business by using the three-stage Discounted Equity Cash Flow model, assuming a sustainable RoE of 15.9%, thus valuing the standalone banking business at Rs. 1,210.

The associate banks have been valued at Rs. 185, based on a target P/B of 1.0x. SBI Life has been valued at a target NBAP (new business achieved profit) multiple of 13x. This gives the life insurance business a valuation of Rs. 124. The AMC has been valued at 4.5% of its AUM. This leads to the valuation of SBI Asset Management at Rs. 13.

Target Price Calculation		
Company	**Value**	**Basis**
SBI - Standalone	1,210	Three Stage DECF model
SBI Associate Banks	185	P/B multiple of 1.0x
SBI Life Insurance	124	13x NBAP multiple, NBAP margin assumed at 20%
SBI Mutual Fund (AMC)	13	4.5% of AUM
SBI International Business	2	Assuming a 12% growth rate for Networth in FY09
SBI's remaining subsidiaries	6	P/B multiple of 1.0x
Total	**1,541**	

At current market price of Rs. 1,301.55, the Bank trades at a discount of 18.4% to our fair value estimate. We believe that the adverse impact of the slowdown has already been factored in the CMP; therefore, we upgrade our rating to **BUY**.

Sensitivity Analysis of the Fair Value Estimate:

Sensitivity Analysis

		Cost of equity				
	-	14.88%	15.38%	**15.88%**	16.38%	16.88%
Terminal growth	11.78%	1,672	1,451	1,286	1,159	1,059
	12.28%	1,896	1,604	1,396	1,240	1,120
	12.78%	2,228	1,817	**1,541**	1,344	1,197
	13.03%	2,461	1,957	1,633	1,408	1,243
	13.28%	2,767	2,130	1,742	1,481	1,295

Income Statement

(Rs mn Yr. ending March 31)	FY07	FY08	FY09E	FY10E
Interest Income	372,423	489,503	666,785	819,727
Interest Expense	221,841	319,291	463,656	580,321
Net Interest Income	**150,582**	**170,212**	**203,129**	**239,405**
YoY Growth (%)	*-3.4%*	*13.0%*	*19.3%*	*17.9%*
Other Income	67,653	86,949	96,024	108,897
Net Operating Income	**218,235**	**257,162**	**299,153**	**348,303**
YoY Growth (%)	*-5.2%*	*17.8%*	*16.3%*	*16.4%*
Operating Expense	118,235	126,086	149,627	178,655
Pre-Provisioning Profit	**99,999**	**131,076**	**149,526**	**169,647**
Provisions and Contingencies	23,555	24,499	35,467	43,758
Profit Before Tax	**76,444**	**106,576**	**114,058**	**125,889**
Tax	31,031	39,285	39,920	44,061
Net Profit	**45,413**	**67,291**	**74,138**	**81,828**
YoY Growth (%)	*3.1%*	*48.2%*	*10.2%*	*10.4%*

Balance Sheet

(Rs mn, as on March 31)	FY07	FY08	FY09E	FY10E
Cash and balances with RBI	519,687	674,663	908,386	1,198,748
Investments	1,491,489	1,895,013	2,525,261	3,164,084
YoY Growth (%)	*-8.2%*	*27.1%*	*33.3%*	*25.3%*
Advances	3,373,365	4,167,682	5,292,956	6,328,168
YoY Growth (%)	*28.9%*	*23.5%*	*27.0%*	*19.6%*
Fixed Assets (Net)	28,189	33,735	35,495	38,539
Other Assets	252,923	444,170	559,283	684,864
Total Assets	**5,665,652**	**7,215,263**	**9,321,382**	**11,414,404**
Deposits	4,355,211	5,374,039	6,825,030	8,326,537
YoY Growth (%)	*14.6%*	*23.4%*	*27.0%*	*22.0%*
Borrowings	397,033	517,274	724,184	977,648
YoY Growth (%)	*29.6%*	*30.3%*	*40.0%*	*35.0%*
Other Liabilities & Provisions	600,423	833,623	1,211,780	1,483,873
Total Liabilities	**5,352,667**	**6,724,937**	**8,760,993**	**10,788,057**
Share Capital	5,263	6,315	6,349	6,349
Reserves & Surplus	307,723	484,012	554,040	619,998
Total Equity & Liabilities	**5,665,652**	**7,215,263**	**9,321,382**	**11,414,404**

Key Ratios

	FY07	FY08	FY09E	FY10E
Per share data (Rs.)				
Shares outstanding (mn)	526.3	631.5	634.9	634.9
Basic EPS	86.3	106.6	116.8	128.9
Diluted EPS	86.3	106.6	116.8	128.9
Book value per share	594.7	776.5	882.7	986.6
Adj. book value per share	594.7	776.5	882.7	986.6
Valuation ratios (x)				
P/PPP	5.2x	7.7x	5.3x	4.7x
P/E	11.5x	15.0x	10.7x	9.7x
P/B	1.7x	2.1x	1.4x	1.3x
P/ABV	1.7x	2.1x	1.4x	1.3x
Performance ratio (%)				
Return on avg. assets	0.9%	1.0%	0.9%	0.8%
Return on avg. net worth	15.4%	16.8%	14.1%	13.8%
Balance Sheet ratios (%)				
Advances to deposits	77.5%	77.6%	77.6%	76.0%
Borrowings to advances	11.8%	12.4%	13.7%	15.4%
Investments to assets	26.3%	26.3%	27.1%	27.7%
Investments to deposits	34.2%	35.3%	37.0%	38.0%
Net Worth to assets	5.5%	6.8%	6.0%	5.5%
Productivity ratio (Rs.mn)				
Opt. expense per employee	0.6	0.7	0.8	0.8
Net profit per employee	0.2	0.4	0.4	0.4
Asset per employee	30.6	40.3	48.0	53.3
Operating ratios (%)				
Operating cost to operating income	54.2%	49.0%	50.0%	51.3%
Operating cost to avg. assets	2.2%	2.0%	1.8%	1.7%

Source: Bank data, Indiabulls Research

Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Bank

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