India

Banks

Company report

Asia Pacific Equities

8 Aug 2002

Fundamental issues

BUY

(Unchanged)

State Bank of India

Flexing its muscle

Hemindra HAZARI
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Price
Rs231.50

Target price
Rs335.00

Sensex
3,011

Market Cap
US$2,504m
Free float
40%
Daily t/o (3 mths)
US$0.9m
Ord shares issued
526m
Major shareholder
RBI (59.7%)

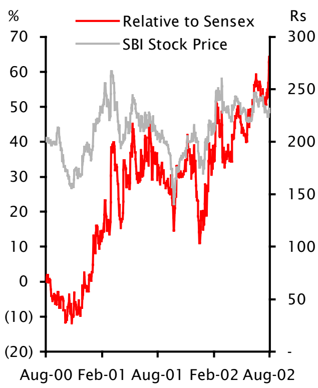
Next results
Interim: Qtly; Final: Mar

Reuters / Bloomberg
SBI.BO/ SBIN IN

Consolidation makes SBI an even more formidable player in the Indian banking industry, dwarfing its nearest rivals in size, distribution and financial muscle. SBI is fast shedding its image as a technology dinosaur through an ambitious information technology plan, which should transform the bank into an agile competitor. The voluntary retirement scheme in FY01 and natural attrition in coming years will lower salary costs and drive profitability in the medium term.

- **Consolidation enhances fundamentals.** Consolidation discloses the true strength of the SBI group and its dominance over its peers. None of the competitors can match SBI for size, financial clout and its unparalleled network for deposits and selling products.
- **Lower salaries and IT plan provide flexibility.** Sharp declines in headcount and a comprehensive technology plan are set to transform SBI into a modern, agile bank, which can wrest the initiative from the smaller, technology-orientated private banks.
- **Beefing up assets.** SBI is resorting to low-risk, more profitable mortgages to diversify risk on its loan portfolio and create a cushion for its investments. Reducing the duration of investments should also protect against interest rate risks.
- **Relaxation of foreign-holding could boost stock.** With the government considering relaxing the 20% foreign-holding ceiling on SBI, this should remove technical constraints on the stock. We value SBI at Rs335/share, or PBV of 0.8x. Our BUY recommendation is unchanged.

Rel performance chart



Year to 31 Mar	01A	02A	03F	04F	05F
Net profit (Rsbn)	16	24	29	34	39
Pre-tax profit (Rsbn)	26	37	45	52	60
EPS (Rs)	30.48	46.22	55.63	63.93	74.54
YoY change (%)	*(21.8)*	*51.6*	*20.4*	*14.9*	*16.6*
BVPS (Rs)	229	269	328	394	469
NDPS (Rs)	5.00	6.00	6.00	7.00	7.50
PE (x)	7.6	5.0	4.2	3.6	3.1
PE rel to index (%)	*60.0*	*44.3*	*41.8*	*38.8*	*41.9*
P/BVPS (x)	1.0	0.9	0.7	0.6	0.5
Yield (%)	2.2	2.6	2.6	3.0	3.2
ROE (%)	13.3	18.6	18.6	17.7	17.3

Performance data (%)	1 m	3 m	12m	12-month range (Rs)
Actual price	*(4.0)*	*(1.2)*	*11.5*	139.85-264.70
Relative to index	*6.2*	*13.8*	*23.3*	

Contents

Note: All prices quoted herein are as of market close on 2 Aug 2002.

Consolidation enhances fundamentals

SBI already dominates the banking industry with its 9,034 branches and 90m retail relationships. By retaining its 20% market share and steady growth in assets and profitability (ROE) over FY95-02, it has held its own in a competitive banking sector, despite the entry of private banks in the early 1990s. This position is further strengthened by consolidation. Consolidation has increased SBI's deposit market share to 25% from 20% and credit market share to 27% from 19%. Its retail base also increased significantly, to 120m. After consolidation, SBI's earnings showed a 38% jump while its BV rose 27%. We believe SBI group is trading at a very low FY03 PE of 3.2x and P/BV of 0.5x cf. the bank's standalone PE and PBV of 4.2x and 0.7x respectively.

SBI group towers above its nearest competitors

Consolidation has given SBI added leverage against domestic competition, along with ICICI Bank, India's second largest bank. Compared to ICICI Bank, the SBI group is 9.6x larger in terms of deposits (ex Resurgent India Bonds and Indian Millennium Bonds) and 3.5x bigger in terms of credit. SBI group's net worth of c. Rs179bn (net of unamortised VRS expenditure) is 2.9x that of ICICI.

Market share of Large Banks

FY02 (%)	Deposits	Credit
SBI group	*24.8*	*27.0*
Punjab National Bank	*5.8*	*5.0*
Bank of Baroda	*5.0*	*4.1*
Bank of India	*4.5*	*4.2*
ICICI Bank	*2.9*	*6.9*

Note: ICICI Bank's credit market share is significantly larger than its deposit market share because erstwhile ICICI entire credit is included while only ICICI Bank's deposits are included and not erstwhile ICICI's other borrowings (which are not bank deposits).

Source: SG Research

Consolidated P/L: SBI Group vs SBI

FY02 Rsbn	SBI	SBI group	% chg
Net interest income	90.8	124.0	*36.6*
Fees	28.0	37.4	*33.6*
Treasury profits	3.5	11.1	*217.1*
Foreign exchange profits	4.1	5.6	*36.6*
Other operating income	6.0	7.5	*25.0*
Other income	41.6	61.6	*48.1*
Total Income	132.4	185.6	*40.2*
Overheads	(72.0)	(97.5)	*35.4*
Operating profit	60.4	88.1	*45.9*
Provisions	(36.1)	(53.6)	*48.5*
Minority interest	0.0	(1.0)	
Net Profit	24.3	33.5	*37.9*
EPS (Rs)	46	64	*37.9*
Cost to income (%)	*54.4*	*52.5*	

Source: SBI

Consolidated Balance sheet: SBI Group Vs SBI

FY02 Rs bn	SBI	SBI group	% chg
Net worth	152	194	*27.4*
Minority interest	0	6	
Deposits	2,706	3,514	*29.9*
Borrowings	93	103	*10.8*
Other liabilities	531	672	*26.6*
Total Liabilities	3,482	4,489	*28.9*
Cash	650	737	*13.4*
Fixed assets	24	31	*29.2*
Other assets	149	203	*36.2*
Credit	1,208	1,663	*37.7*
Investments	1,451	1,855	*27.8*
Total assets	3,482	4,489	*28.9*
Book Value (Rs)	289	369	*27.4*
Loan/Deposits (%)	*45*	*47*	

Source: SBI

Consolidation Increases SBI's profits and profitability

On the income side, SBI group's consolidated net earnings increased 38% and operating income was up 40%. Net interest margin for the group was higher, at 3.1% cf. SBI's 2.9%. Fee income to total income was lower for the group, probably because SBI enjoys higher fee income from larger companies. Profitability ratios like ROE and ROA were also higher for the group than SBI.

Although the group and bank's net NPLs are similar at 5.6%, the group's Tier-1 capital is lower at 8.6% cf. SBI's 9.2%. SBI is better capitalised than its subsidiaries and has a lower amount of risk-weighted assets, as SBI group's loan-to-deposit ratio of 47% is higher than the bank's 45%.

SBI group offers full array of financial products

SBI is India's first universal bank that also offers non-commercial banking services. Through its subsidiaries the group offers customers a full array of financial products, from traditional commercial banking to asset management, investment banking, primary dealing, credit cards and life insurance. With the exception of a few start-ups (like life insurance and credit cards) all subsidiaries are profitable. For the first time in its history, the SBI board adopted consolidated accounts for FY02. In FY02, subsidiaries' accounts were merged to provide consolidated accounts of the SBI group.

Subsidiaries	SBI holding (%)	FY02 net profit (Rsm)
State Bank of Bikaner & Jaipur	*75*	1,645
State Bank of Hyderabad	*100*	2,265
State Bank of Indore	*98*	1,251
State Bank of Mysore	*92*	659
State Bank of Patiala	*100*	2,329
State Bank of Saurashtra	*100*	820
State Bank of Travancore	*75*	1,209
SBI Commercial & International Bank Ltd	*100*	32
SBI Capital Markets Ltd.	*86*	188
SBI Funds Management Ltd.	*100*	14
SBI Factors & Commercial Services Ltd.	*70*	5
SBI Gilts Ltd.	*82*	775
SBI Securities	*97*	27
SBI Cards & Payments Services Ltd.	*60*	(10)
SBI Life Insurance Company Ltd	*74*	(3)
SBI Canada	*100*	n/a
SBI California	*100*	n/a
SBI-International Mauritius	*98*	n/a
Indo-Nigerian Merchant Bank	*51*	n/a
SBI Finance Inc.	*100.*	n/a
SBI Servicos Limitada	*99*	n/a

Source: SG Research

Associates contribute 90% of subsidiaries' profits

SBI's domestic bank subsidiaries contribute the bulk of the subsidiaries' earnings

SBI has eight domestic commercial bank subsidiaries. Apart from SBI Commercial and International Bank, the banks are referred to as associates. SBI's shareholding in these banks ranges from 75-100%. The associates are governed by a separate act of Parliament – the State Bank of India (Subsidiaries Banks) Act, 1959. If the associates were merged into a single bank, the merged entity would be India's third largest bank. In our opinion, the assets, liquidity and earning quality of the subsidiaries are superior to ICICI Bank. Around 90% of SBI's subsidiaries' profits and c. 85% of subsidiaries' net worth are from the associate banks.

Non-bank subsidiaries to leverage on SBI's strengths

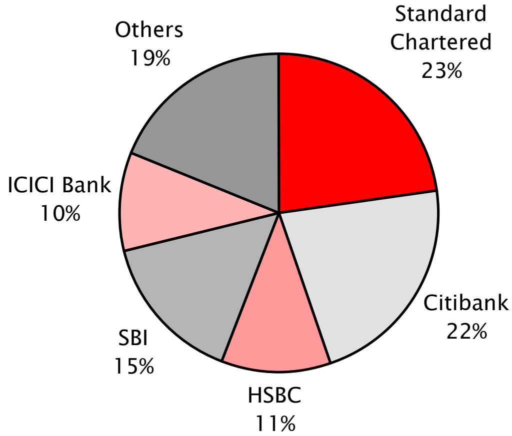
Through its non-bank subsidiaries, SBI has exposure in areas like investment banking, credit cards, life insurance, asset management and primary debt dealing.

Non-bank subsidiaries to leverage on SBI group's 120m customers

The main non-bank subsidiaries are SBI Gilts, SBI Capital Markets, SBI Funds Management, SBI Cards and Payment Services and SBI Life Insurance. SBI Gilts, a primary debt dealer, reported profit of Rs775m in FY02 cf. Rs319m in FY01 due to the declining interest rate environment. Investment bank SBI Capital enjoys the SBI brand name and has large government divestment mandates. Media reports have pointed to BNP Paribas' interst in taking a stake in SBI Funds, which should improve assets under management and increase its profile.

SBI Cards and Payment Services, a JV with GE Capital, has leveraged the group's branches to become the third largest issuer of credit cards in India (after Standard Chartered Bank and Citibank) with a market share of 15% in only three years. The JV uses GE Capital's processes and technology, with SBI's distribution and client database. NPLs are estimated at 3%, provision to debtors over six months is c. 82% and net interest margin is c. 13%.

Credit card market share (%)



Source: SG Research

Group's future earnings expected to be >30% than SBI Bank's

Our forecast SBI earnings, on which we set our target price, only takes into account the bank. We have however, made preliminary estimates of SBI Group's earnings. We believe that associates' earnings growth in FY03 would be marginal as FY02 profits received a boost from treasury gains. From FY04 we expect associate profits to increase by c. 17% p.a. Despite the marginal increase in FY03, SBI group trades at an attractive FY03 PBV of 0.5x and an ROE of 18.6%.

Consolidation with SBI

Rsm	FY2002	FY2003E	FY2004E	FY2005E
SBI net profit	24,316	29,277	33,646	39,230
Less dividend received from subsidiaries	(1,027)	(1,159)	(1,339)	(1,528)
Share of subsidiaries profits	10,078	10,482	12,267	14,344
Consolidated net profits	33,367	38,600	44,574	52,046
SBI EPS (Rs)	46.2	55.7	64.0	74.6
Consolidated SBI EPS (Rs)	63.4	73.4	84.7	98.9
Growth over standalone SBI	*37.2%*	*31.8%*	*32.5%*	*32.7%*
SBI net worth	141,603	172,647	207,149	246,972
Share of subsidiaries net worth	46,913	53,035	62,362	75,177
Consolidated net worth	188,516	225,682	269,511	322,149
SBI NAV (Rs)	269.2	328.2	393.8	469.5
Consolidated SBI NAV (Rs)	358.4	429.1	512.4	612.5
Growth over standalone SBI	*33.1%*	*30.7%*	*30.1%*	*30.4%*
SBI ROE	18.6	18.6	17.7	17.3
SBI consolidated ROE	19.3	18.6	18.0	17.6
SBI ROA	0.74	0.79	0.80	0.83
SBI consolidated ROA	0.79	0.81	0.83	0.86

Source: SG Research

Strategic importance of SBI's branches

SBI's franchise and strong brand recall is derived from its extensive branch network. This lets SBI offer lower rates of interest on its deposits than competitors, serves as an unparalleled distribution network to sell financial products (thus increases market share faster) and balances SBI's cash flow. The network is a key competitive strength, which is expensive and difficult for competitors to match.

SBI group branches dominate rivals

SBI bank has >9,000 domestic branches, while its subsidiaries together have a network of >4,500. The group's overall domestic network is almost 13,600 strong. Such a large distribution network provides the group with a significant advantage in terms of corporate and retail customers and provides an excellent distribution channel to market financial products. SBI's IT roll-out plan is aimed at integrating the associate banks as well.

Domestic branches & customer accounts

FY02	Branches	Accounts (m)
SBI group	13,544	>120
Punjab National Bank	3,857	30
Bank of Baroda	2,641	20
Bank of India	2,529	n/a
ICICI Bank	350	5
HDFC Bank	171	2.2

Source: Banks

Distribution unparalleled

The group's distribution is unparalleled, covering >120m customers. Furthermore, the branches come at historical costs and the initial operating losses of the branches set up in the late 1950s and early 1960s were subsidised by the RBI. It will be extremely difficult for any bank, especially of the new generation, to establish a distribution network that even come close to comparison.

SBI group branches FY02	Rural	Semi-urban	Urban	Metro	Foreign	Total
SBI	4,059	2,449	1,486	1,040	51	9,085
State Bank of Bikaner & Jaipur	326	216	135	125	0	802
State Bank of Hyderabad	285	275	175	150	0	885
State Bank of Indore	129	123	121	36	0	409
State Bank of Mysore	214	146	110	134	0	604
State Bank of Patiala	279	189	171	84	0	723
State Bank of Saurashtra	138	134	69	70	0	411
State Bank of Travancore	34	482	107	51	0	674
Total of Associates	1,405	1,565	888	650	0	4,508
SBI Commercial & International	0	0	0	2	0	2
SBI group	5,464	4,014	2,374	1,692	51	13,595

Source: SG Research

SBI's branch network dwarfs its competitors. In comparison, the combined branch strength of other large government banks like Bank of India, Bank of Baroda and Punjab National Bank only reaches c. 9,030. Moreover, branches of large government banks tend to be more regionally focused – PNB primarily in the north; Bank of Baroda and Bank of India in the west. Against new banks like HDFC Bank and ICICI Bank there is no comparison – ICICI has only 350 branches, HDFC has 171. Although the private bank branches are all networked, while SBI's are not, the planned IT roll-out aims to have 3,000 networked branches by FY05, thus neutralising a critical advantage that the private banks now have over SBI.

Lower rates on deposits

Branch network allows SBI to offer lower interest rates on deposits

SBI offers the lowest interest rates on its deposits. Its branch network allows SBI to offer the lowest rate on retail deposits and yet mobilise deposits to retain market share. SBI's rates are c. 25-75bp lower than HDFC Bank and ICICI Bank.

Rates of Interest on Retail Deposits

%	SBI	HDFC Bank	ICICI Bank
61-180 days	*6.00*	*6.00*	*6.00*
181 days-1 yr	*6.25*	*7.00*	*7.00*
1-2 yrs	*7.00*	*7.50*	*7.50*
2-5 yrs	*7.50*	*7.75*	*7.75*

Source: SG Research

About 25% of SBI's deposits are from semi-urban areas and 13% from rural areas, which provides a low-cost deposit base. In contrast, many new banks tend to have an urban concentration.

SBI has a high proportion of low-cost deposits (current and savings). Despite its low level of technology, SBI's savings deposits are a high 20.8%. SBI's figures would be even stronger if the RIB and IMD funds were excluded from its term deposits. The US$4.2bn RIB will mature in Aug 03 and the US$5.5bn IMD in Nov 05. Excluding the RIB and IMD, savings deposits would be 25% and current deposits 19%.

The higher component of low-cost deposits results in SBI having a lower average cost of funds than competitors, except for HDFC Bank. One reason why SBI has a higher cost of funds than HDFC Bank (apart from the RIB/IMD funds and HDFC Bank's higher current deposits) is that SBI has c. Rs100bn in employee provident funds in its term deposits where the rate of interest is fixed at 9.5%. While these funds are more expensive they are long-term as they are paid out when employees retire. Since the average tenure of SBI employees is 35 years, SBI has the advantage of long-term funds from this source.

Branch manager structure also allows better cross selling

Branch manager model important for cross selling

The branch structure is also crucial in cross selling financial products. The branch manager structure can enhance cross selling, unlike the product line structure of the newer banks, as managers can identify prospective customers, and more importantly, they can know the customer. This is vital in terms of follow-up or recovery of bad loans. Leveraging the branches for selling products has been particularly successful for credit cards and mortgages. Sales of credit cards and mortgages disbursed have been linked to branch managers' performance revenues, as well as the number of delinquent customers that they recommended. It is this model that has made SBI the third largest credit card issuer, with low delinquencies and the second largest mortgage lender – and all in a short timeframe.

Newer banks developed their branches only for deposit mobilisation and have evolved a highly centralised model on a product-line basis. Widespread use of technology can cope with retail volumes in terms of acquiring, processing and sanctioning loans, but in cases of follow-up and recovery of bad loans, dependency on outside agencies in India following up on large volumes of delinquencies can be difficult.

Branches in rural and urban India means stable cash flow for SBI

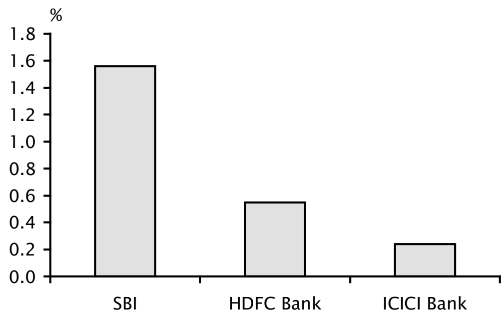
SBI's extensive branch network provides stable cash flow. In industries that have urban-rural linkages like textiles, SBI has found that when industry takes loans for financing rural purchases, funds remain with SBI as the rural party either use said funds to repay the loan from SBI or places it as a deposit with the bank. SBI's network thus enables it to be at both ends of the transaction.

Lower salaries and IT plan provide flexibility

Constituting a very high 70% of total costs, employee costs have historically had a dampening effect on profitability and remain a key profit factor. However, lower employee costs will drive an improvement in ROA. FY01's Voluntary Retirement Scheme (VRS) reduced employee costs to 1.56% of average total assets from an historic 2%, while employee attrition should increase in future. According to our estimates headcount is estimated to drop 9% and salaries to average total assets should fall to 1.45% by FY05.

VRS and natural attrition to lower employee costs

Staff costs as % of average assets



Source: SG Research

High employee costs weigh down ROA and is a key contributor to operating inefficiency. SBI's employee costs to average total assets of 1.56% is nearly 3x HDFC Bank's. In some ways SBI is incomparable with the new private banks as it was set up in 1955 to develop rural and semi-urban areas, promote national development and to develop banking in non-metropolitan areas. This strategy resulted in the opening and staffing of branches in rural and semi-urban areas, which hit SBI's profitability. The branch network exploded from c. 450 in 1955 to c. 9,030 in FY02, while staff numbers grew from 15,000 to c. 210,00 in the same period. Branch expansion was so rapid that in 1970-85 SBI was on average opening a branch a day.

New banks started with modern technology and minimal staff

In contrast, the new banks were established in the early 1990s with a mandate to introduce modern IT systems in their banks. They were not burdened with setting up rural and semi-urban branches. High employee costs at SBI are the result of manual operations across its extensive branch network.

VRS lowers cost burden

VRS in SBI reduced headcount by 9%

The VRS that SBI introduced in FY01 saw headcount trimmed by 9%, with a total of c. 21,330 employees (from c. 232,500) opting for early retirement. The VRS cost Rs23bn, with an average payout of Rs1.1m/employee. The scheme had a positive effect on profitability, bringing SBI's cost-to-income ratio down to 54% from an historic 60%. The staff cost to average total assets ratio fell to 1.56% from 1.85%.

VRS-II being contemplated

As banks have computerised branches and considering branch networking and online banking, the sector is contemplating another round of VRSs. Bank of India, the fourth largest bank in terms of deposits, has already approached the government for VRS-II.

Natural attrition to reduce staff by 14% in next six years

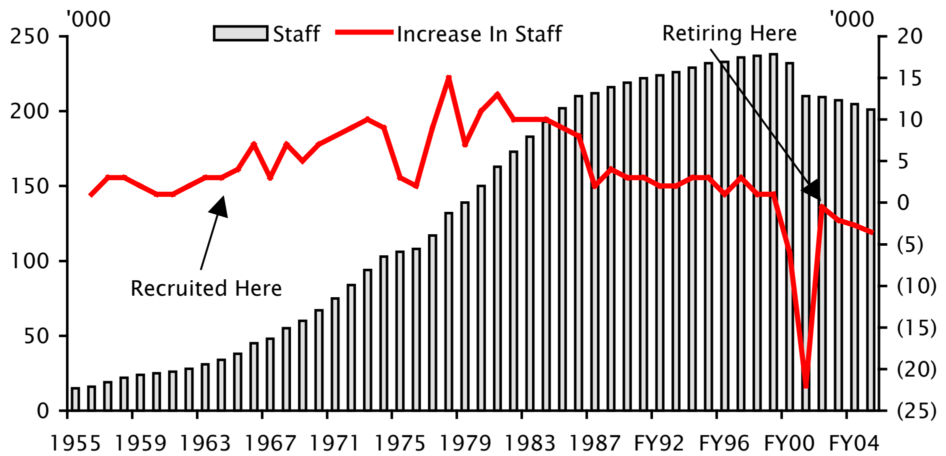
In any event, natural attrition will continue to lower employee numbers. On average, an SBI employee remains in service for 35 years (retirement age is 60). From now on, the bulk of retirees will be those recruited from the mid-60s onwards, when mass recruitment took off. In the future, therefore, SBI's headcount will fall sharply. According to SBI, in the next six years 14% of staff, or c. 30,000, will retire.

Net decline in SBI's headcount

	Retirements	Recruitment	Net decline
FY03	2,600	500	2,100
FY04	3,200	500	2,700
FY05	4,000	500	3,500
FY06	4,500	500	4,000
FY07	7,000	500	6,500
FY08	8,700	500	8,200

Source: SG Research

SBI: natural attrition

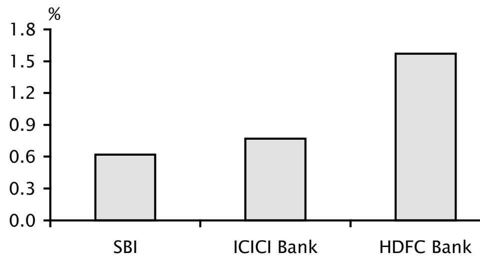


Source: SG Research

SBI's non-staff costs are lower than private banks

SBI's non-staff costs to average total assets is lower than HDFC Bank's and ICICI Bank's as the smaller banks have from the start made huge investments in IT to develop a centralised database and large ATM network. This resulted in significant non-staff costs but was a key competitive advantage over SBI as they could offer better service and facilities. SBI's non-staff costs are expected to increase marginally as it invests in IT to upgrade its branches to neutralise the new banks' advantage. However, total overheads to average total assets should continue to decline, as staff costs to average total assets should decline enough to offset marginal increase in other costs.

Non-staff cost to assets

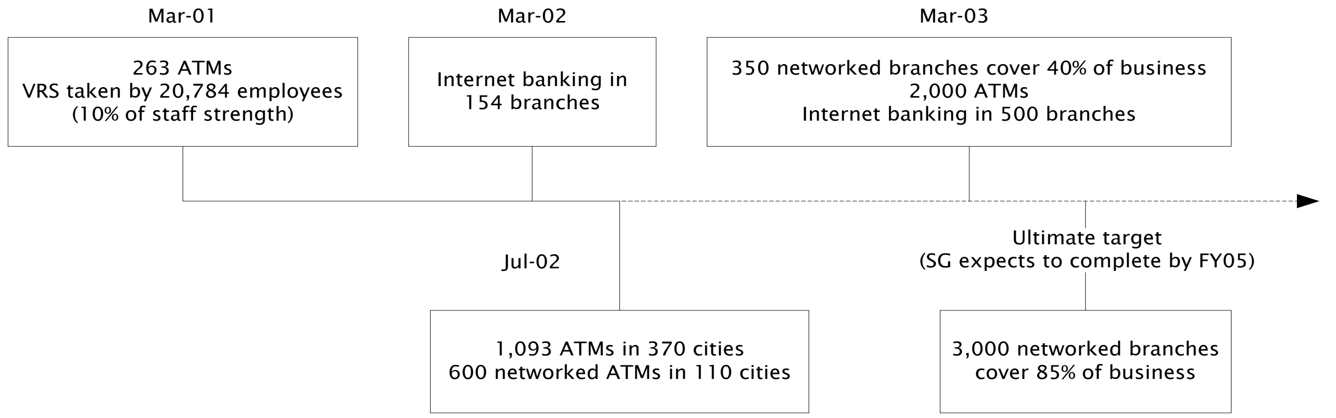


Source: SG Research

IT to transform SBI

SBI is implementing major plans to shed its image of a technology dinosaur. SBI plans to invest Rs5bn in technology in the next three years for branch networking, internet banking, ATMs and for treasury operations. Once implemented, SBI will have the most networked branches. SBI already has the largest number of ATMs and plans to install a core banking solution in them. Once the IT platform is launched, SBI's products, especially retail, can be more easily facilitated. The dinosaur is fast evolving to an agile, responsive bank.

IT restructuring



Source: SG Research

3,000 branches to be networked

SBI's core banking solution involves networking 3,000 branches, accounting for 80% of business (deposits and credit). At present 3,000 branches are computerised but not networked for centralised data processing. The networking will be phased. Phase 1, will see 350 branches, accounting 35% of the bank's business in 49 cities, networked by FY03. Phase 2 will see c. 2,650 additional branches linked by FY05

SBI has selected Datacraft of Singapore as the network integrator. The network will support SBI as well as its seven associate banks, letting the group operate as a single unit.

Internet banking is being implemented with Broad Vision and Satyam. The target is to offer this service in 500 branches by FY03. Internet banking is currently offered in just 154 branches under the brand name *online.sbi.com*.

Oracle is providing SBI with a solution for its asset-liability management product and Reuters and Unisys will assist in setting up the treasury-management mechanism.

Largest number of ATMs

In FY02, SBI surpassed ICICI Bank as the bank with the most ATMs. SBI set up an additional 807, taking its total to 1,070 in 370 cities. Though only 568 ATMs in 110 cities were networked, the speed at which SBI undertook this mission was surprising. In the last five weeks of FY02, SBI installed 554 ATMs. The bank is also the largest issuer of ATM cards with more than 1.8m cardholders in FY02. ICICI Bank ended the year with 1,005 networked ATMs.

Banks' ATMs

FY02	Net worked ATMs	Standalone ATMs	Total
SBI	568	502	1,070
ICICI Bank	1,005	0	1,005
UTI Bank	491	0	491
HDFC Bank	479	0	479

Source: SG Research

In our estimates we have assumed IT costs of Rs900m in FY03, Rs1.26bn in FY04 and Rs1.56bn in FY05. Cost savings will be considerable following implementation. According to SBI, the cost of a manual transaction is Rs76 while an ATM transaction costs only Rs26, thereby saving Rs50. The system should also result in better customer service, higher transaction volumes and less manpower requirements. SBI's cost-to-income should improve through higher volumes and lower transaction costs although it is premature to quantify the gains.

VRS-II is a distinct possibility by FY04-05 as SBI officials say 10-40% of staff could be made redundant following the IT investment. While it is possible that the bulk of the redundant employees could be re-deployed and trained for other functions, a VRS involving a 10% reduction in headcount is possible.

Beefing up assets

From a risk management perspective, SBI has been trying to lessen the interest rate and asset quality risks of its portfolio. It has reduced the duration of its substantial government securities holdings and created undisclosed reserves to hedge against interest rate risk. In terms of loans, SBI has diversified into low-risk and more profitable mortgages, easing its concentration on corporate loans, which are vulnerable to economic slowdowns.

Managing interest rate risk

Bank investments in excess of 25% SLR

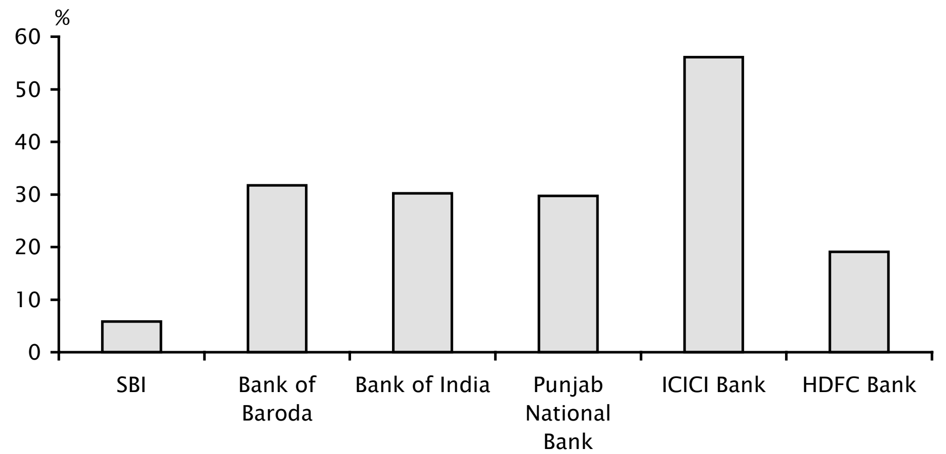
Indian banks have to invest 25% of their deposits in government and other approved securities in order to meet a minimum statutory liquidity ratio (SLR). The banking sector currently maintains excess investments, as deposit growth has been strong but avenues for lending limited.

In FY02, SBI's investments in domestic government and related securities stood at Rs1.69tn cf. domestic credit of Rs1.08tn. Its SLR investments to assets has increased to 35% from 26% in FY99. In the same period, credit to assets has declined to 35% from 37%. While government securities entail no default risk, banks still have to manage interest rate risk.

In FY02, because of the slowdown in commercial credit growth, income from loans was under pressure. But as interest rates were on a downtrend, banks were able to book significant profits from their bond portfolios and thus meet market profit expectations.

In contrast to other banks, however, SBI did not book significant profits from its bond portfolio and instead created a cushion of unrealised gains to meet any subsequent loss in FY03 from a rise in interest rates.

Treasury profits to pre-provision profits

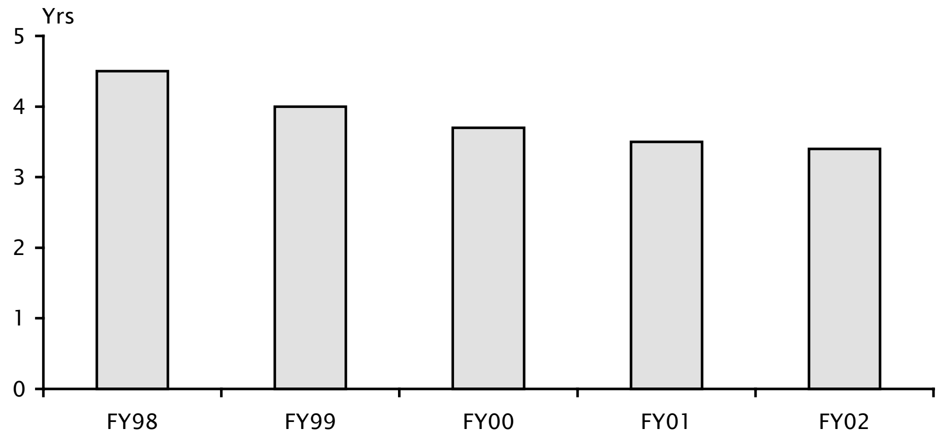


Source: SG Research

SBI's size and dominance limit strategies for managing risk

SBI's large government securities portfolio (at c. 28% of the banking industry's outstanding holdings) makes it difficult for it to be hedged as no counterparties match that size. To reduce the interest rate risk of its portfolio and to prevent volatile overall earnings, SBI has been reducing the duration of its portfolio. SBI's current portfolio duration is 3.4 years cf. 4.5 years in FY98. The cushion of unrealised gains also acts as an effective hedge.

Duration of SBI's domestic portfolio



Source: SG Research

Theoretically, in FY03 for every 1ppt rise in interest rates SBI would have to provide Rs15bn in investment depreciation. But according to SBI, it has a cushion in its investment portfolio to absorb a 4ppt rise in interest rates. This essentially means SBI has a Rs60bn investment cushion, which was created in FY02 when it chose not to book treasury profits like other banks.

Low-risk and more profitable mortgages to diversify risk

SBI's entry into the mortgage market, a segment long dominated by HDFC has created waves. Confronted by poor corporate credit growth and deposit inflows, SBI turned to mortgages as a way to diversify its portfolio, enhance overall credit growth and ease the pressure on margins.

SBI's mortgage portfolio catching up to HDFC's

Starting from a negligible base of Rs49bn (including c. Rs24bn in employee mortgages) in FY01, SBI increased its mortgage portfolio to Rs81.8bn in FY02 and plans to increase it further to Rs127bn in FY03. To put SBI's mortgage portfolio in perspective, HDFC has built a retail mortgage portfolio of Rs126bn over a period of 25 years.

We believe the diversification into mortgages is a positive move. Mortgage growth has been fuelled by lower interest rates, falling real estate prices and higher levels of government tax exemptions. The RBI has reduced the risk weight on mortgages to 50% from 100% and the level of NPLs is generally low (HDFC has a NPL ratio of 0.9%). The move also helps to lessen SBI's concentration on corporate credit and thus vulnerability to industrial recession. Mortgages of <Rs1m qualify as priority sector loans (40% of bank lending has to be to the priority sector) and since mortgages are of low risk cf. other priority sector loans, banks have an incentive to push mortgages. Mortgages are also more resilient than corporate loans amid economic downturns.

SBI's low cost of funds is a key advantage

SBI, with its low cost of funds, has a clear advantage over market leader HDFC and other banks. Banks can raise low-cost funds through savings and current deposits, and can raise short-term (less than one year) retail deposits. On a marginal cost basis, SBI's interest cost adjusted for the SLR and cash reserve ratio (CRR) is 1.9ppt below HDFC. Even after factoring in total overheads, SBI's total cost of funds is 0.4ppt below HDFC's. In our cost of funds analysis we have factored in the total SLR, even though SBI and most of the other government banks have an SLR in excess of the stipulated minimum.

Cost of funds	HDFC	SBI	ICICI Bank
Amount raised (Rs)	100.0	100.0	100.0
Pre-emption			
Statutory liquidity ratio (SLR)	4.5	25.0	25.0
Cash reserve ratio (CRR)	0.0	5.0	5.0
Total funds for SLR/CRR	4.5	30.0	30.0
Amt. net of SLR & CRR	95.5	70.0	70.0
Yield on SLR/CRR			
Yield on SLR (%)	*8.0*	*7.0*	*7.0*
Yield on CRR (%)	*0.0*	*3.0*	*3.0*
Earnings on CRR/SLR (Rs)	*0.36*	*1.9*	*1.9*
Composition of Bank Deposits			
Current (%)	*0.0*	*16.6*	*8.5*
Savings (%)	*0.0*	*19.7*	*7.7*
Term deposits (%)	*100.0*	*63.7*	*83.8*
Total deposits	*100.0*	*100.0*	*100.0*
Cost of deposits			
Current account (%)	*0.0*	*0.0*	*0.0*
Savings account (%)	*0.0*	*3.5*	*3.5*
Term deposits (%)	*8.3*	*8.0*	*8.5*
Wt av. cost of funds (%)	***8.3***	***5.8***	***7.4***
Interest Cost (Rs)	8.3	5.8	7.4
Interest Cost adj. For CRR & SLR (Rs)	8.7	8.3	10.6
Less earnings on SLR & CRR (Rs)	0.4	1.9	1.9
Actual interest cost (Rs)	**8.3**	**6.4**	**8.7**
Plus overheads (Rs)	0.6	2.2	1.0
Total cost (Rs)	**8.9**	**8.5**	**9.7**

Source: SG Research

Mortgage business highly profitable

A low risk weight makes mortgages an attractive area for banks. Indeed, SBI's ROE from mortgages is marginally higher than HDFC's, despite higher overheads, NPLs and taxes on the 50% risk weight for the bank cf. 75% for HDFC.

In our comparison of SBI and HDFC, we have incorporated full overheads even though in SBI's case its overheads should be spread out across all loan products. HDFC is a single-product entity.

SBI's mortgage business is even more profitable than lending to prime-rated companies as yields to blue chips are lower and the risk weight is double than that of mortgages. In our analysis we have assumed mortgages and loans to prime-rated borrowers have a similar 2% NPL ratio.

Profitability (%)	SBI	SBI	HDFC
Product	**Prime Corporate**	**Mortgage**	**Mortgage**
Yield	*10.0*	*11.2*	*11.8*
Cost adj for CRR & SLR	*6.4*	*6.4*	*8.3*
Net interest income	*3.6*	*4.8*	*3.5*
Other income	*1.0*	*0.0*	*0.0*
Total income	*4.6*	*4.8*	*3.5*
Overheads	*2.2*	*2.2*	*0.6*
Operating profit	*2.4*	*2.7*	*2.9*
Provisions	*0.4*	*0.4*	*0.2*
PBT	*2.0*	*2.3*	*2.7*
Tax	*0.7*	*0.8*	*0.5*
Net profit	*1.3*	*1.5*	*2.1*
ROE	*13.2*	*29.3*	*28.3*
Assumptions			
Risk weight	*100*	*50*	*75*
Tier-I capital	*10*	*10*	*10*
NPL	*2*	*2*	*1*
Tax rate	*35*	*35*	*20*

Source: SG Research

Asset-liability management

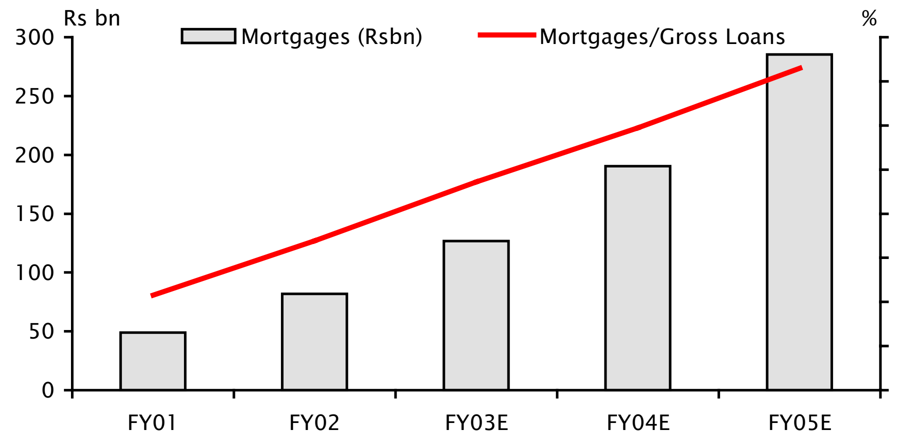
The only major concern banks have in terms of mortgages is asset-liability management. Bank funding is typically short-term while mortgages tend to be for 10-15 years. Managing interest rate risk is a key issue as banks lack long-term fixed-rate deposits.

Mortgages form c. 7% of gross loans and 3% of deposits

For SBI, the solution lies in emphasising more variable rate linked mortgages or capping the mortgage exposure to overall loans. At 36%, SBI has one of the highest current and saving deposits to total deposit ratios in the industry. These deposits are typically rolled over and most regarded as core deposits. Mortgages form c. 7% of gross loans and 3% of deposits. Moreover, unlike other large government banks, SBI has c. Rs100bn in long-term deposits in the Employees Provident Fund (EPF), which are treated as a lendable resource for the bank. Other government banks have to invest the EPF proceeds in government securities.

According to our estimates, mortgages will constitute 14.6% of loans and 7% of deposits by FY05. We therefore are not overly concerned on the asset-liability front as SBI has high levels of savings and current deposits.

Mortgages/gross loans and mortgage outstanding



Source: SG Research

By FY05, we expect SBI to be the market leader in mortgages (valued at c. Rs285bn) and estimate the NPL ratio in this portfolio to be c. 2%. We expect the contribution of mortgages to net earnings to increase to 9%, from 6% in FY03.

Asset quality concerns overdone

New ordinance to control incremental NPLs

NPLs and asset-quality concerns have dogged Indian banks and have contributed to the de-rating of government bank stocks. Asset quality emerged as a key problem because of weak foreclosure laws and a legal system that favours the borrower at the expense of the lender.

At end-Jun 02, however, the government passed a presidential ordinance (See Appendix 2) which Parliament has to ratify in six months. The ordinance should be beneficial to banks as it grants them the power to seize delinquent assets without a court order. The ordinance should arrest incremental NPL growth and facilitate cash recovery from NPLs.

We believe concerns over SBI's asset quality have been overstated, but understated for ICICI Bank. While SBI's credit monitoring, internal audits and accountability systems slow its decision-making process, they help keep asset quality in check. At SBI all loan proposals are documented and any modifications have to be noted and signed off by relevant officials. Additionally, major proposals have go through various internal credit committees, which then verify borrowers' documentation and assess them.

SBI's gross NPLs

Rsbn	FY00	FY01	FY02
Opening gross NPL	140.65	152.46	158.75
Additions	36.81	43.53	41.70
Reductions	(25.00)	(37.24)	(45.59)
Closing gross NPLs	152.46	158.75	154.86

Source: SBI

NPLs declining

SBI's gross NPLs in FY02 declined on account of higher write-offs. Its gross NPLs declined to Rs155bn from Rs159bn in FY01. Fresh additions to gross NPLs stood at Rs42bn in FY02, lower than the Rs43.5bn in FY01. Net NPLs to net worth also declined to 48% from 57%.

In general, SBI's accounting of NPLs is conservative cf. other banks and, in our opinion, superior to ICICI Bank's: e.g. the loan to Lloyds Steel was classified as an NPL by SBI in FY99 while ICICI Bank classified it as a standard loan in FY01. For FY02, SBI estimates gross NPLs to increase by only Rs10.9bn based on a 90-day past-due norm.

Top 10 NPL accounts at SBI in FY01

Borrower	Amount (Rsbn)
Harshad Mehta	8.12
Hindustan Photo Films	2.34
Alpine Industries	1.64
Mafatlal Industries	1.53
Lloyds Steel	1.12
SIRIS	0.81
Remi Metal Gujarat	0.62
CRB Capital	0.61
Modern Denim	0.61
Shah Construction	0.44

Source: RBI & AIBEA

Worst-case scenario: stress loans would reduce FY03 BV by 18%

Indian banks do not disclose their largest defaulters to the public but this data is published by the RBI and recently by the All-India Bank Employees Association (AIBEA). SBI's largest NPL account is Harshad Mehta, a stock broker that allegedly utilised bank funds to prop up the share market in the early 1990s.

According to discussions we have had with serving and retired SBI senior officials and RBI inspectors, loans at the bank are strictly classified and provided for along RBI norms. We therefore do not believe SBI has NPLs that are classified as standard loans.

However, SBI has lent to cash-strapped companies and though servicing the loans, they are of poor quality. The main stress loans are to Dabhol Power (an Enron subsidiary) estimated at Rs18bn and large private sector steel companies (Essar, Ispat and Jindal) estimated at Rs17bn. Incremental NPLs based on 90-day norm and restructured standard loans stand at Rs10.9bn. In addition to reported gross NPLs of Rs155bn, we estimate stress loans amount to Rs60.5bn (our estimate may involve double-counting as some of the companies could be included in the 90-day estimate or in the restructured standard loan category). In a worst-case scenario, assuming the average interest paid on stress loans is 14.5% and SBI provides a cover of 55%, the bank's FY03 BVPS would decline 18% to Rs268 from our current estimate of Rs328.

Banks could reschedule loans because of natural disaster

Agricultural production may be negatively affected in FY03 by drought. At least 18% of domestic banks' loans have to go to agriculture. SBI's exposure stands at Rs162bn. At this stage it is difficult to ascertain the impact of the drought on bank loans. In natural disasters, regulators tend to allow banks to reschedule loans. Although regulators to date have yet to issue any instructions, if the drought persists or worsens we believe banks will be allowed to reschedule agricultural loans.

Significant undisclosed reserves

Undisclosed reserves a legacy of the past

SBI's conservative accounting and its legacy of maintaining undisclosed reserves have allowed it to create a significant cushion not readily apparent in its accounts. SBI's undisclosed reserves of Tier-2 capital and unrealised gains on its investment portfolio could raise its FY03 BV by 35%, underlining strong fundamentals.

Undisclosed reserves in Tier-2 capital

SBI is probably the only Indian bank that has significant hidden reserves, in addition to published reserves. The Bank for International Settlements (BIS) permits banks to include such undisclosed reserves as part of their Tier-2 capital.

These reserves have characteristics similar to equity and disclosed reserves. They represent accumulation of post-tax profits and are not encumbered by any known liability. Therefore, the BIS has ruled, they should not be used for absorbing normal losses.

Since Indian banks are not required to disclose the composition of Tier-2 capital we estimate the value of undisclosed reserves by deducting from Tier-2 capital our estimate of subordinate debt and general provisions. We estimate SBI's undisclosed reserves at Rs21.5bn.

Reserve uses

Reserves can be utilised for unforeseen liabilities

The reserves serve two purposes. First, SBI can utilise them for bad debt provisions or if any unexpected liability were to arise. But such an accounting treatment would be detected as banks have to disclose total Tier-2 capital. To date, SBI as not taken any such deductions from its undisclosed reserves even when its NPLs exceeded analysts' estimates. The bank has prudently charged all bad debt provisions above the line. SBI could also classify the secret reserves as a specific provision, thereby increasing the coverage ratio and reducing its net NPLs. In FY02, for example its coverage ratio would have improved to 70% from the reported 56.5% and net NPLs would have declined to Rs46.6bn from Rs68.1bn.

Reserves can increase Tier-1 capital without dilution

Second, instead of raising additional equity capital, which would dilute earnings, SBI could disclose and transfer the hidden reserves to published reserves. The bank can either do this in one shot or gradually to smooth the impact on ROE. If the entire reserve had been transferred to published reserves in FY02, Tier-1 capital would have improved to 10.7% from 9.2% and the ROE would have declined to 16.8% from 18.1%.

Comfortable cushion outdated

Unrealised gains from government bond portfolio estimated at Rs60bn

SBI has said its unrealised gains on its investment portfolio could withstand a 4ppt increase in interest rates. We estimate unrealised gains from its government bond portfolio to be Rs60bn, which is at the lower end of market estimates (Rs60-140bn). Our estimate would account for c. 40% of Tier-1 capital.

Although SBI's secret reserves are indicative of the bank's strong underlying fundamentals and prudent accounting, we are not overly enthusiastic about the concept and believe its days are numbered. The BIS and the Indian regulator (a majority shareholder in SBI) may still cling to this concept, but US GAAP accounting does not recognise the secrecy. Shareholders, and more importantly depositors, should have the right to know the actual strength of the bank. The secret reserves distort its true financial strength and reported performance.

Relaxation of foreign-holding could boost stock

We believe a relaxation of SBI's foreign-holding limit is imminent as the government is encouraging more foreign investment in private banks. The relaxation in foreign holding could act as a share price catalyst, as SBI's valuation is attractive even from a regional perspective. At present, foreigners have to pay a premium for the stock. Based on our two-stage dividend discount model, we value SBI at Rs335/share or 0.8x FY03 BV.

Since the issuance of GDRs on 3 Oct 96, the foreign holding in SBI has been restricted to 20%, including foreign direct investment (GDR/ADS, strategic partner), foreign institutional investment and investment by non-resident Indian and overseas corporate bodies. The ceiling has limited foreign interest in the bank and domestic interest has waned. A relaxation in the ceiling could result in an upsurge of the stock price.

SBI Act does not mandate maximum foreign holding

The SBI Act of 1955 does not impose any foreign ownership restrictions on SBI but the Nationalised Bank Act has a 20% ceiling on foreign ownership of nationalised banks. At the time of SBI's GDR, the government notified the bank to bring the ceiling on par with nationalised banks. Should the governemnt decide to relax the ceiling, the SBI Act would not need be amended, but the Nationalised Bank Act would.

SBI wants GDRs excluded from foreign-holding limit

SBI has reportedly requested that the government exclude the GDRs from the 20% ceiling. GDRs currently comprise c. 10% of the limit. While the government may heed SBI's request, we believe the bank would not be privatised i.e. managerial control would still be influenced by the government.

A matter of time

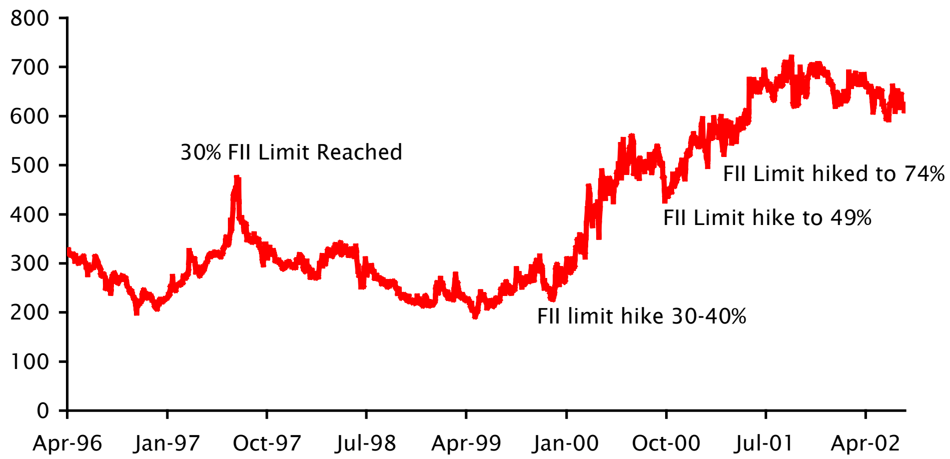
Government relaxing foreign ownership in private banks and other sectors

We believe it is only a matter of time before the government relaxes the foreign ceiling on government banks. There has been a clear policy shift towards encouraging foreign ownership (both portfolio and strategic) in Indian banks and other protected sectors. Examples include:

- Foreign banks permitted to have 100%-owned bank subsidiaries in India.
- Foreign banks with a branch presence in India allowed to own 49% of private Indian banks. Prior to this, foreign banks could not own stakes in Indian banks. ING Bank has said it plans to increase its stake in Vysya Bank to 49%.
- By allowing the ICICI-ICICI Bank merger, which created India's second-largest bank on 26 Apr, the government acknowledged that it is comfortable allowing significant foreign ownership in a large Indian bank. Foreign ownership in ICICI Bank stands at 44.3% (ADS 25.7% and FIIs/NRIs 18.6%).
- In a significant policy departure the government has allowed foreign ownership in the Indian news media as well, despite strong lobbying by dominant Indian media groups. The government allowed foreign direct investment up to 26% in news and current affairs print media and up to 74% in technical and medical publications as of 25 Jun. This reversal nullified a 1955 cabinet resolution prohibiting foreign investment in print media.
- Strategic changes the government has undertaken mark a clear break from the past. In some cases the government has overturned >40-year-old policies. The policy on foreign ownership of government banks is inconsistent with the policy for private banks and other strategic sectors of the economy. We therefore believe that SBI has a strong case for the relaxation of the foreign-ownership limit.

Relaxing the foreign-ownership limit in a fundamentally strong company should be a positive trigger for the stock. HDFC's share price has spiked proportionately whenever the foreign-holding limit has been increased (see chart).

HDFC: relaxation of FII limit



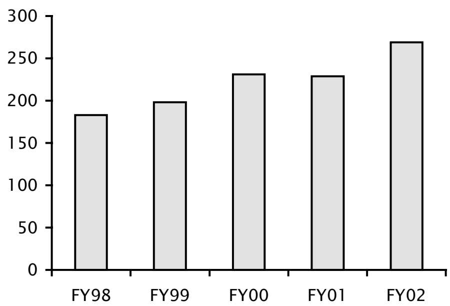
Source: SG Research

Improving fundamentals

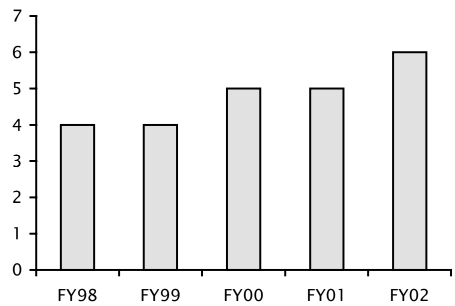
Re-rating imminent: structures are being put in place

Over the years, SBI has been consistently de-rated and penalised for being a government bank, for its lack of technology and for its foreign-ownership cap. However, SBI's fundamentals have been improving, with its book value and dividend per share rising.

SBI – BVPS



SBI – DPS



Source: SG Research

Our two-stage model relates PB multiples to ROE and the duration of a fast-growth period, while our estimate of sustainable dividend growth is subject to the capital constraints of individual banks. Based on our assumptions, SBI has an upside of 45% based on a PB of 0.8x FY03.

Two-stage model valuation and implied PB

	Recomm	Stage 1	DPS Growth		ROE		COE	Jun-03	Fair	Effective	Target	Implied
		EPS grth	Stage 1	Stage 2	Stage 1	Stage 2	(SG est.)	BVPS	P/B	prem/	price	target P/B
		(%)	(%)	(%)	(%)	(%)	(%)		x	(disc)	(Rs)	(x)
SBI	BUY	*9.3*	*17.1*	*9.0*	*15.5*	*17.5*	*16.9*	413	0.81	0.0	335	0.81
ICBK	U/P	*11.8*	*21.9*	*9.0*	*15.1*	*19.5*	*20.4*	115	0.95	0.0	109	0.95
HDFC	U/P	*9.1*	*14.0*	*9.0*	*18.3*	*16.9*	*13.9*	270	1.94	13.3	595	2.20
HDBK	U/P	*11.7*	*18.5*	*9.0*	*17.5*	*17.4*	*14.4*	73	2.09	0.0	154	2.09

Source: SG Research

Most attractive in the sector

SBI is our preferred pick in the sector. The consolidation of its accounts, technology upgrades, a reduction in headcount, reduced asset risk and a possible relaxation of the foreign-shareholding limit are, we believe, re-rating triggers for the stock.

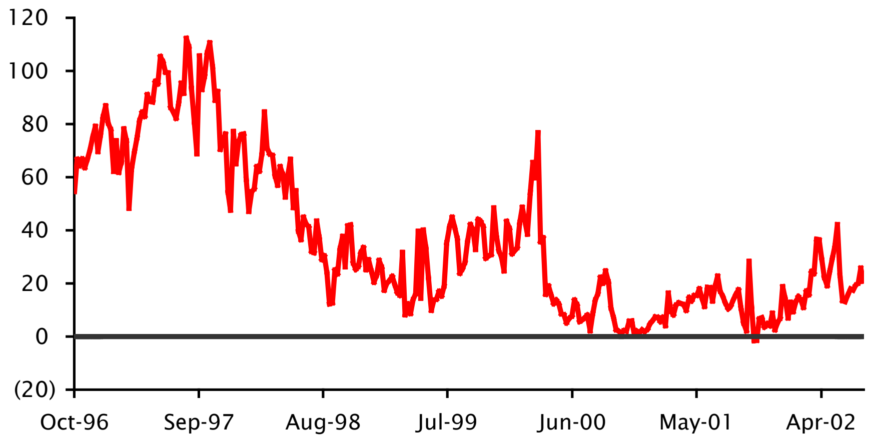
Of our current fair value targets for Indian banks we are positive only on SBI. Despite ICICI Bank's improving ROE, we have significant concerns about its asset quality and liquidity management as it grapples to replace high-cost wholesale deposits with low-cost retail funds. ICICI Bank's aggressive forays into retail loans could also create future problems, as non-mortgage retail loans entail high risk in the absence of a credit bureau in India.

Long-term profitability for HDFC under threat

HDFC Bank has traded at a premium to other Indian banks, but this was justified as earnings growth and asset quality were superior. Now, however, we believe quality growth will be difficult for HDFC Bank and existing valuations are unjustified. Our long-term view on HDFC is that high profitability from a single product is now vulnerable to competition. HDFC may be able to fend of competitors for the next two or three years, but its long-term profitability may not be sustainable. We forecast declining ROEs and ROAs.

In light of SBI's strong 1QFY03 results we have increased our FY03-05 earnings estimates by 5% and consequently upgraded our target price by 7% to Rs335. We rate the stock a BUY.

GDR premium over local price



Source: SG Research

Corporate summary

Corporate history & background

Corporate history & background

SBI, India's largest bank with assets of US$71bn, traces its origins to 1806, with the establishment of the Bank of Calcutta to service the requirements of the mercantile community in British India. The Bank of Bombay was established in 1840 and the Bank of Madras was set up thereafter. In 1921, the Bank of Calcutta, the Bank of Bombay and the Bank of Madras were amalgamated to form the Imperial Bank. In 1955, the controlling interests of the Imperial Bank were acquired by the Reserve Bank of India (RBI) and SBI was created on 1 July 1955 by an Act of Parliament. At 31 March 02, SBI had 9,034 domestic branches and 51 foreign branches. SBI's market share in credits is 18% and 20% in deposits. SBI has eight domestic bank subsidiaries, with seven governed by SBI (Subsidiaries Banks) Act, 1959. SBI group's market share in deposits is 25% and 30% in credit.

Shareholder & management

The majority 59.7% shareholder in SBI is the RBI. As per the SBI Act, the RBI has to maintain a minimum 55% holding. No shareholder other than the RBI can excercise voting rights in excess of 10% of the issued capital, even if a shareholder holds >10% in SBI. The RBI nominates one director and the government can appoint a maximum of seven directors; minority shareholders can nominate a maximum of four directors. The appointment and remuneration of the executive directors (chairman and two managing directors) is determined by the government, not the board.

The Act gives the chairman wide ranging powers and in theory, all the power at the bank – although in practice decisions are ratified by the board. Janki Ballabh, a career SBI officer, is the bank's executive chairman and was appointed chairman on 1 Nov 00. He retires on 31 Oct 02. Prior to his appointment as chairman, Ballabh was deputy mangiang director of international operations.

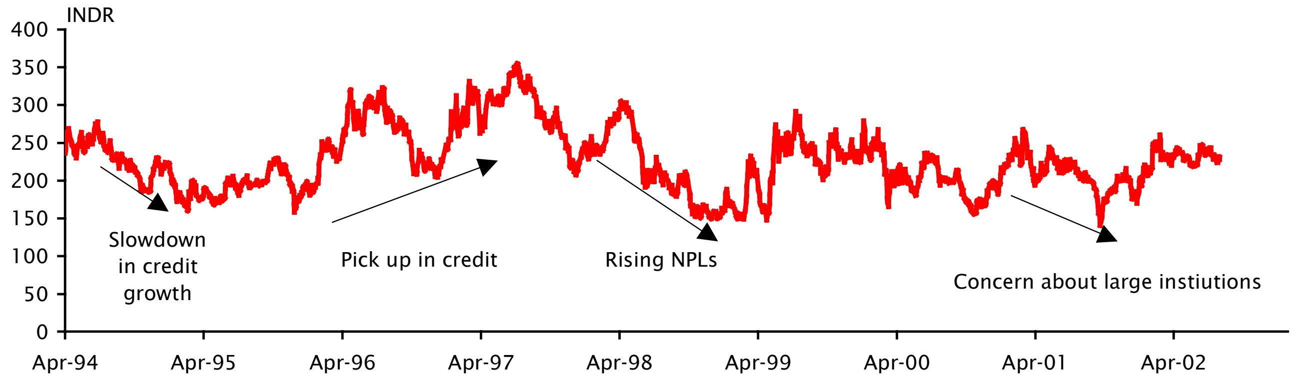
Brief summary of the bank's mission statement

SBI's mandate after 1955 was to spread modern banking throughout India to create a force for national economic development, particularly in rural and semi-urban sectors. In the aftermath of deregulation in the early 1990s, the bank set itself the following goals: 1) to improve profitability while consolidating its position as India's largest bank, and 2) to capitalise on the opportunities presented by deregulation by developing and marketing new products and services to enhance profitability.

New products, M&As and divestment

In the 1990s, SBI was late to launch new products, but is now starting to make a significant impact. In 1999, SBI Cards and Payment Services, a JV GE Capital, introduced SBI credit cards, an industry segment dominated by foreign banks. By early 02, SBI was the third-largest issuer of credit cards. In 2001, SBI identified mortgages as a key low-risk growth segment and by FY02 had become the second largest mortgage financier, with plans to overtake HDFC in the next two years. In 2001, SBI made a foray into the life insurance business through a JV with Cardif SA, and formed SBI Life Insurance. The government has deregulated the life insurance sector to allow private sector activity. SBI leverages its extensive branch network to distribute these new products.

10-year share price history



Industry analysis (performance and macro background)

Industry performance ^

Y/E March (%)	96A	02A	03F	04F
Asset quality & provision *				
Gross NPL loan ratio	4.1	7.4	6.9	6.2
Provision charges / avg loans	0.78	1.26	0.71	0.69
Provision charges / PPP	13.7	28.4	15.3	14.6
Capital strength & funding *				
Tier 1 ratio (simple avg.)	17.5	10.5	10.0	9.6
Avg. LTD ratio	100.0	121.6	112.4	111.9
Profitability *				
Pre-provision ROA	2.87	2.20	2.12	2.16
ROA	2.12	1.31	1.39	1.43
ROE	17.1	16.9	18.0	19.1
Market share				
Top 3 as % of local banks' loans	32.6	25.9		
Top 3 as % of bank system loans	29.5	24.0		
Local banks as % bank system's total loans	90.7	92.7		

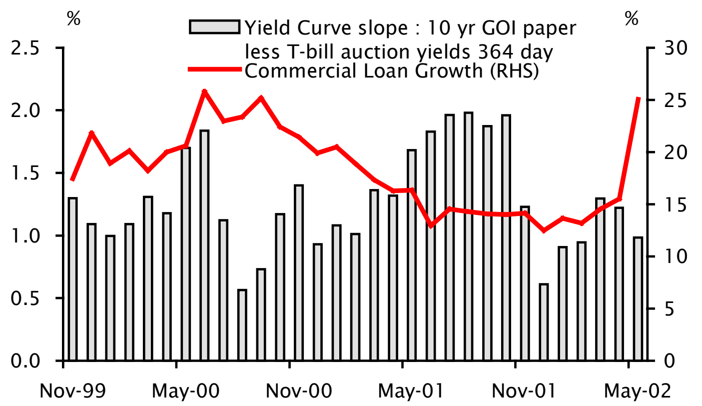
^ Calculated on simple average

FY02 should be close to the bottom of the economic cycle, as corporate credit growth has decelerated. Since restructuring began in FY99, asset turnover ratios have improved and growth in fixed assets and borrowings have been lower than sales growth. Manufacturing companies reduced working capital requirements and with the excess capacity set up before FY99, investments in fixed assets slowed considerably.

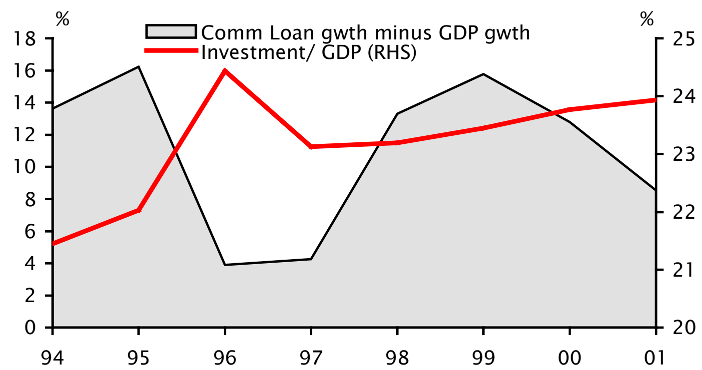
There are some indications of a pick-up in credit, although it appears too early to signify a trend. Margins are expected to remain under pressure, due to increasing competition. ROA improvement should come from lower employee costs as staff numbers moderate.

SBI's major employee and branch expansion took place from the mid-1960s to the mid-1970s. Those recruited from 1965 should start retiring soon. The decline in employee costs for SBI is the main reason why ROA is better than FY96, even though NIM was considerably higher back then.

Yield curve slope vs loan growth



Commercial loan growth vs real GDP growth



Recent history of Indian bank sector

FY95-96: Credit growth high but interest rates also peak with SBI's PLR at 16.5% by YE95. Liquidity was tight in FY96.

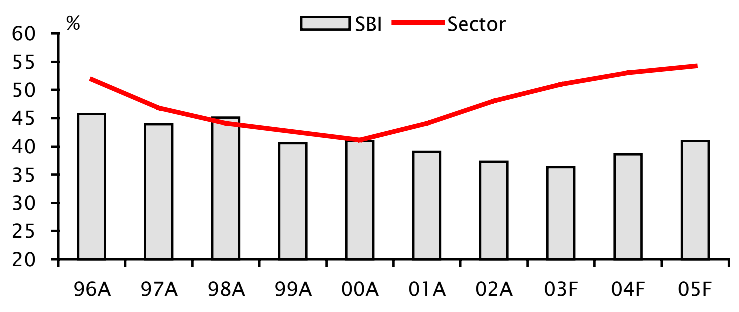
FY97: Credit growth declined to 9.6% cf. 20% in FY96, as industrial production grew 6% cf. 11.6% in FY96.

FY98-present: Interest rates on a secular decline but no significant increase in industrial production. GDP growth slowed to c. 5.6% from c. 6.5% in FY99-00. Banks were flush with liquidity and investment in goverment securities were more attractive than loans because of NPL fears.

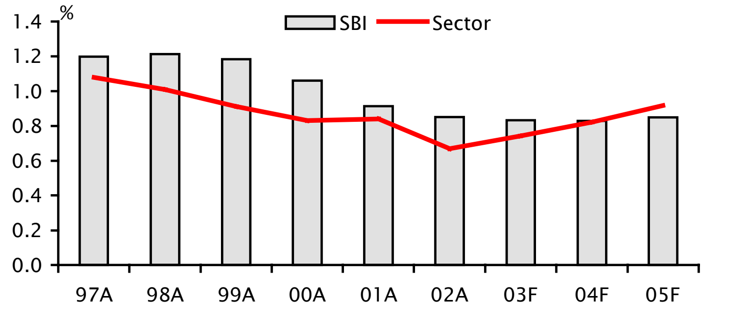
Although there are some signs of a credit recovery, we believe credit will only pick up from FY04 onwards. Corporate NPLs are still rising in absolute terms. In the absence of quality corporate credit, banks are pushing mortgages for superior risk-adjusted returns.

Industry analysis (revenue growth & ROA drivers)

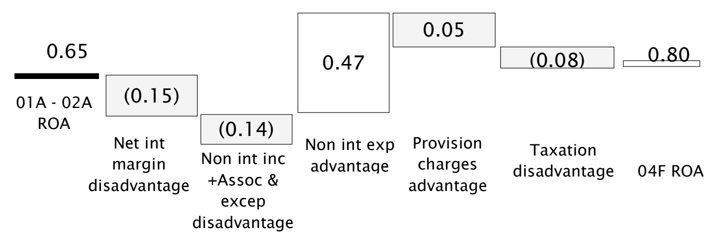
Loans as % of average total assets



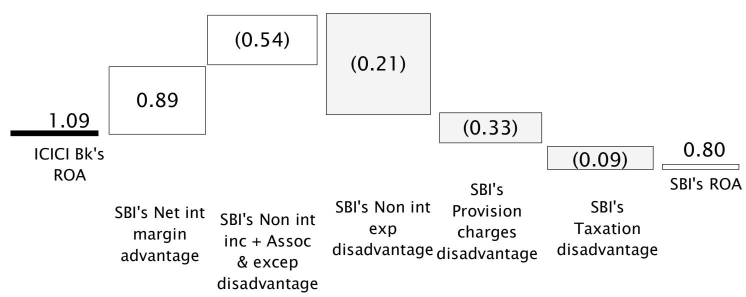
Fees as % of average total assets



SBI's ROA decomposition (04F vs 01A - 02A)



ROA component analysis vs ICICI Bk (04F)



Compare & contrast

SBI has lower loans to assets cf. HDFC Bank and ICICI Bank, as they are both in high growth phases. Moreover, the merger of ICICI with ICICI Bank, has increased the loan to asset sector ratio as ICICI did not have any pre-emptions, unlike banks. SBI, like the other large government banks, has been investing more in government securities in excess of mandatory requirements because of high NPLs associated with corporate lending. Companies have also been restructuring and borrowing less from banks. In future, we expect SBI's loan to assets to remain stable with some improvement by FY04, as corporate credit picks up.

SBI is well-positioned to take part in the corporate recovery, as it can divest its liquid investment portfolio and should not have funding constraints.

SBI's fee income is higher than the sector's as SBI has greater exposure to the top Indian companies. With SBI's IT roll-out, companies should prefer to work with SBI because of its distribution network.

c. 25% of SBI's fee income is from government transactions, a key competitive edge. It is difficult for others to make significant inroads into this area, as it is labour intensive and requires a large infrastructure. Fees from government are core and do not entail any fund outlay from SBI.

ROA decomposition

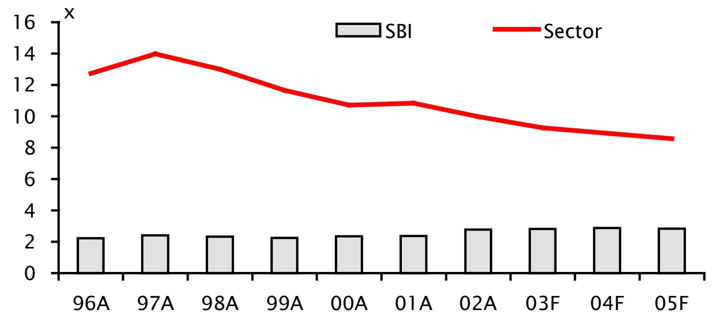
The main driver of ROA is lower employee costs, as a large numbers recruited after 1965 retire. Margins will come under pressure as there is higher concentration of exposure to large companies. SBI is increasing its mortgage exposure, but it will take time to influence overall interest margins.

SBI has a clear cost of funds advantage over ICICI Bank due to its extensive branch network. ICICI Bank has higher non-interest income on account of treasury profits. SBI loses out on overheads because ICICI Bank is a new bank and enjoys the benefits of new technology and an employee incentive system. SBI has higher provisions because it is more conservative.

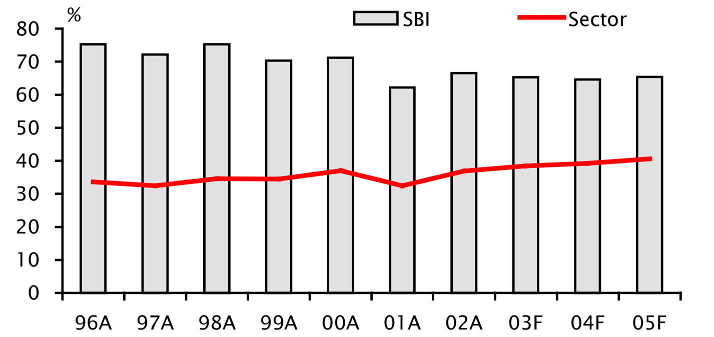
Industry analysis

Operating analysis (efficiency & productivity)

Revenue to staff costs



Staff costs/total non-cash operating expenses



Growth of non-staff costs

Staff costs and overall cost growth

	SBI	Sector	ICICI Bk	HDBk
Staff cost / employee (USD'000)				
- 2002A	4.2	6.0	5.8	6.3
- 2003F	4.3	7.7	9.3	9.3
Operating cost growth (% yoy)				
- 2002A	(13.1)	27.2	86.4	35.0
- 2003F	10.1	58.0	159.9	45.8
- 2004F	8.6	20.9	29.4	27.9
- 2005F	12.7	21.5	30.2	25.8
Cost growth ex GW & restruc cost (% yoy)				
- 2003F	10.6	24.1	159.9	45.8
- 2004F	9.0	13.6	29.4	27.9

Staff productivity
Revenue to staff costs is significantly lower than the sector, as SBI is a government bank with no incentive system apart from promotion. Moreover, as a government bank it has less flexibility reducing staff. Labour is unionised and SBI lacks freedom to get rid of unproductive staff, unlike ICICI Bank and HDFC Bank.

In FY01 the bank announced a voluntary retirement scheme and consequently reduced headcount by c. 21,000, or c. 9%.

Historically, SBI has had a larger staff as branch expansion c. 1965-75 lacked technology and transactions were labour intensive. Moreover, handling cash transactions for normal banking operations as well as the government treasury chest required large numbers of cashiers and security staff.

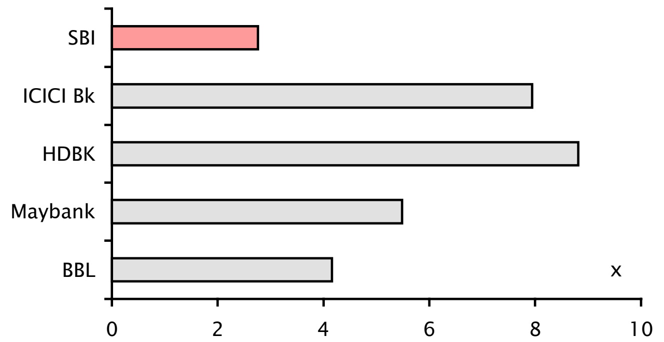
Branch rationalisation
SBI's branch model has more low-productivity rural branches as it was established to promote development. Banks like ICICI and HDFC are free to focus on profit maximisation.

SBI cannot close its rural branches for socio-economic and political reasons, but it has started rationalising branches in non-rural through consolidation. Its IT initiative should increase revenue streams from existing branches and improve future productivity.

Compared with HDFC and ICICI, where staff costs and overheads will continue to rise steeply, SBI's overheads should increase much slower as its infrastructure is already in place. SBI's IT expenditure should be the only rising overhead.

Operating analysis (benchmarking)

Revenue to staff costs (2002)

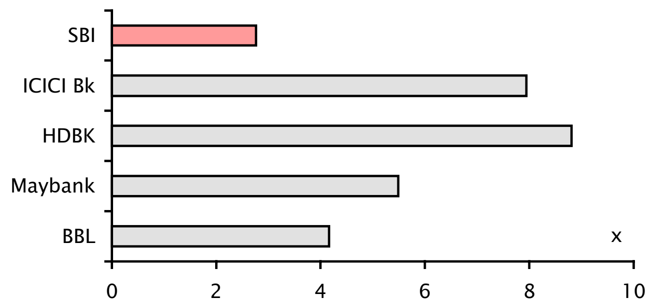


Peer comparison

Revenue to staff costs lags the pack, as staff costs form a comparatively high proprtion of overheads. SBI's labour-intensive branch system renders it incomparable with its peers. A large component of SBI employees are back-office, cashiers or security staff, who do not generate revenue directly. Technology absorbtion has been low and SBI only recently began networking its branches.

The government permitted banks to trim employee numbers in FY01; SBI reduced its labour force by c. 9%. There are expectations that banks may be allowed a second round of reductions.

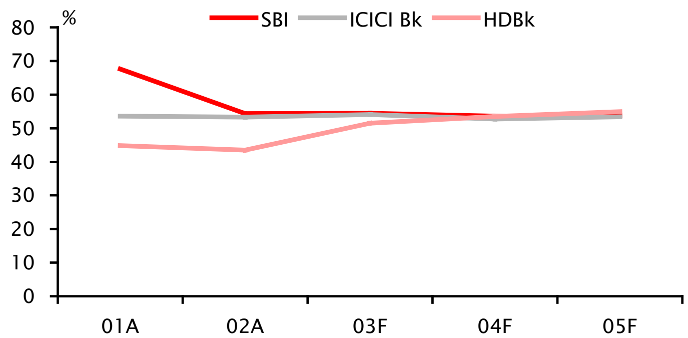
Adjusted cost to assets ratio (2002)



All Indian banks (Mar YE) are showing forecast one year ahead
Note: the adj. cost to asset ratio excl. goodwill and other one-off, restructuring costs

Adjusted cost to assets ratio (ex-restructuring costs and goodwill) is better than its peers. Our explanation is that SBI's asset base is huge, at US$71bn, and this base effect reduces the overall ratio.

Cost to income ratio



Cost to income ratio has come-off sharply following its VRS in FY01. We expect HDFC Bank's cost to income to fall in line with SBI, as new banks have to invest more in branches and increase their footprint. Moreover, on an adjusted cost to income ratio, SBI is favourably positioned as both ICICI Bnak and HDFC Bank booked significant treasury profits, unlike SBI. With SBI catching up on the technology front, costs for new customers are going to increase for smaller banks.

SBI's earnings sensitivity

	NIM (%)	Cost-inc ratio (%)	Attrib. profits (Rsbn)	ROE (%)
2004 base case	2.78	53.6	34	17.7
Assuming +10bp chg. from NIM base case	2.88	52.3	36	19.1
Assuming -10% chg. from op. expense base case	2.78	48.2	39	20.7
Assuming -10bp chg. fr. prov. charge/avg loans base case	2.78	53.6	35	18.3

Earnings are extremely senstive to operational expenses. A 10% decline in the operational expense base case can increase profits by 15% and ROE by 3ppt.

Operating analysis (operational features)

Size comparison	SBI	ICICI Bk	HDFC Bk	Kookmin	Chohung	Maybank	CAHB	BBL	KTB	TFB
Fig. based on last fiscal yr (US$bn unless stated)										
Total assets ex-contras	66.4	22.0	5.0	110.1	42.7	38.5	19.6	28.1	22.0	17.4
Gross loans	25.9	10.9	1.5	80.3	29.2	28.7	11.7	16.2	15.8	10.5
Customer deposits	48.7	5.7	3.6	78.2	28.4	25.4	12.3	24.1	19.5	15.0
Shareholders funds	2.54	1.32	0.41	4.89	1.97	2.64	1.45	0.97	1.43	0.61
Tier 1 capital	2.56	1.24	0.36	4.60	1.67	2.69	1.26	1.18	1.33	0.88
o/w hybrid Tier-1	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.78	0.00	0.45
Off-balance sheet:										
Trust assets	n.a.	n.a.	n.a.	17.30	4.39	n.a.	n.a.	n.a.	n.a.	n.a.
Funds assets under management	n.a.	n.a.	n.a.	n.a.	n.a.	0.42	0.79	n.a.	n.a.	n.a.

Measures of non-traditional activities	SBI	ICICI Bk	HDFC Bk	Kookmin	Chohung	Maybank	CAHB	BBL	KTB	TFB
Fig. based on last fiscal yr & in % unless stated										
Investment portfolio										
Securities investment / total assets	39.3	34.5	50.5	21.1	25.1	15.9	26.7	20.8	4.9	14.8
o/w Govt. debt secur./total assets	32.5	21.9	22.3	6.9	9.5	4.9	10.2	16.3	3.1	9.4
o/w Corp debt secur./total assets	5.1	n.a.	27.5	20.0	23.9	9.8	15.1	2.2	0.9	3.6
o/w Equity secur./total assets	0.7	0.3	0.6	1.0	1.2	0.7	0.9	2.3	1.0	1.9
Customer franchise & fund										
Cur. + sav. as % cust. deposits	38.2	19.3	42.5	n.a.	19.6	32.3	30.2	31.4	27.6	35.1
Deposits as % borrowed funds	89.4	29.7	85.7	81.6	76.5	79.9	75.6	90.9	96.2	91.4
Trust assets / customer deposits	n.a.	n.a.	n.a.	22.1	15.5	n.a.	n.a.	n.a.	n.a.	n.a.
AUM / customer deposits	n.a.	n.a.	n.a.	n.a.	n.a.	1.7	6.4	n.a.	n.a.	n.a.

Revenue & cost mix	SBI	ICICI Bk	HDFC Bk	Kookmin	Chohung	Maybank	CAHB	BBL	KTB	TFB
Fig. based on last fiscal yr & in % unless stated										
Business mix (as % of revenue)										
Net interest income	67.2	50.8	65.4	73.1	48.3	71.1	67.7	67.6	76.8	64.6
Net fees & commissions	21.5	24.2	17.1	21.2	43.9	11.7	13.7	26.7	17.5	20.6
Dealing profits	2.5	25.0	14.8	4.5	6.6	2.6	12.0	3.1	1.4	9.3
Other non-interest income	8.8	0.0	2.7	1.2	1.2	14.7	6.5	2.6	4.3	5.6
Cost mix (as % of non-int expense)										
Staff costs	62.2	23.6	26.1	57.5	40.3	48.6	58.5	34.8	30.8	34.9
Government tax & levies	0.0	0.0	0.0	4.3	3.9	0.0	0.0	8.3	7.5	7.3
Restructuring costs	10.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating costs	27.6	76.4	73.9	38.3	55.8	51.4	41.5	56.9	61.7	57.8
Goodwill amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Margins, costs & efficiency	SBI	ICICI Bk	HDFC Bk	Kookmin	Chohung	Maybank	CAHB	BBL	KTB	TFB
Fig. based on last fiscal yr & in % unless stated										
Yield on earning assets	9.73	3.66	9.29	9.51	7.44	6.11	5.74	4.95	4.16	5.08
Av. cost of funds	7.62	2.86	6.55	6.92	5.06	3.45	3.34	3.11	2.22	2.96
Spread	2.11	0.80	2.73	2.58	2.38	2.66	2.40	1.83	1.94	2.12
Net interest margin	3.09	1.01	3.43	3.25	2.38	3.08	2.35	1.94	2.05	2.20
Compensation ratio	42.1	12.6	11.3	25.4	14.6	18.3	26.7	24.0	24.2	28.1
Cost-to-income ratio	67.7	53.3	43.4	44.1	36.2	37.7	45.6	69.0	78.5	80.6
Cost/inc (ex-GW & secur inv)	60.7	53.3	43.4	44.1	36.2	37.7	45.6	69.0	78.5	80.6
Effective tax charge	37.7	11.0	30.2	30.6	(55.3)	47.1	27.0	0.0	0.0	38.2
Av. assets/av. no. employee (US$'000	274.7	2,757.6	1,282.2	4,303.2	6,101.1	1,733.7	1,710.4	1,448.7	1,427.6	1,579.4
Revenue per employee (US$'000)	11.7	52.0	62.6	162.0	264.2	71.3	64.2	40.9	36.8	52.0
Avg. staff cost (US$'000)	4.9	6.5	7.1	41.1	38.6	13.1	17.1	9.8	8.9	14.6
Employees (FTE, y/e)	210,280	5,344	3,742	22,613	6,585	20,000	10,300	18,705	15,233	10,472

Financial analysis (diversification and risk management)

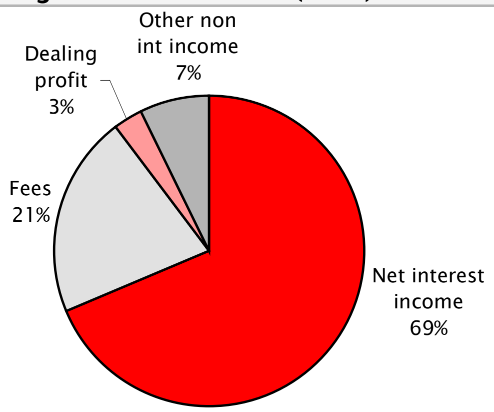
Balance sheet structure (2002)

Figs in % total assets	SBI	Sector	ICICI Bk	HDBk
- Loans	37.3	48.0	49.4	29.4
- Securities invest.	42.1	35.0	34.5	50.5
o/w govt securities	35.3	20.1	21.9	22.3
o/w corp debt securities	5.2	13.7	n.a.	27.5
o/w equity securities	0.7	0.8	0.3	0.6
- RWA	41.9	66.2	75.7	65.8

Credit risk diversification (2002)

Figs in % of total loans	SBI	Sector	ICICI Bk	HDBk
Corporate	50.5	51.2	83.0	67.0
Mortgage	6.8	3.8	6.1	0.0
Non-mortgage retail	7.8	10.5	9.9	21.0
Foreign	11.0	5.0	0.0	0.0
Others	4.9	10.0	0.0	11.0
Food	8.0	8.5	0.0	0.0
Agriculture	11.0	11.0	1.0	1.0
Total	100	100	100	100

Operating income breakdown (2002)



Non-interest income growth

	SBI	Sector	ICICI Bk	HDBk
Non-interest income / asset (%)				
- 2002A	1.3	1.2	0.9	1.7
- 2003F	1.2	1.2	1.5	1.2
Non-interest income growth* (% YoY)				
- 2002A	3.9	65.1	161.4	79.6
- 2003F	8.5	48.3	174.5	(3.2)
- 2004F	10.2	18.8	24.4	25.8
- 2005F	12.2	21.2	32.8	23.6
* o/w growth in fees (% YoY)				
- 2003F	10.0	62.1	175.0	30.0
- 2004F	12.0	27.5	45.0	28.0

Exposure to government securities has been on the up. Like other large banks, SBI holds government securities in excess of mandatory requirements. HDFC Bank and ICICI Bank, being much smaller and still in growth phases, maintain the minimum requirements.
Given limited lending oppurtunities and NPL fears, most large banks have shifted assets into investment securities. This has been a prudent strategy, as NPLs have been rising on corporate loans.

Liquidity is fine and if credit growth were to pick up, SBI would be in a strong position to liquidate its investments to fund credit growth. SBI has been diversifying its loan portfolio, particularly in low-risk mortgages, currently 6.8% of the portfolio. We expect this to increase to 15% by FY05. SBI's strategy is to reduce its exposure to companies which are vulnerable to recession.

SBI's loan portfolio is more diverse than ICICI Bank and HDFC Bank, with a much higher weighting on foreign loans, agricultural loans and food credit (financing food grain procurement on behalf of the government). All large banks have to undertake food credit while agricultural loans are mandatory at 18% of net credit.

Moody's upgraded SBI's local-currency deposit ratings (long and short term). Short-term local currency rating has been upgraded from "Not Prime" to "Prime-2"; long-term from Ba1 to A3. The long term local currency rating for SBI is the highest rating assigned by Moody's to any Indian financial institution.

SBI's growth potential and the quality of non-interest income to assets is marginally higher than the sector. The quality of other income is superior to the sector, as its fee income component is higher. SBI has higher fees due to handling government transactions and from major corporate clients. Core fee income (unrelated to fund outlays like guarantees, letters of credit, etc) is higher because of remittances due to its extensive branch network.

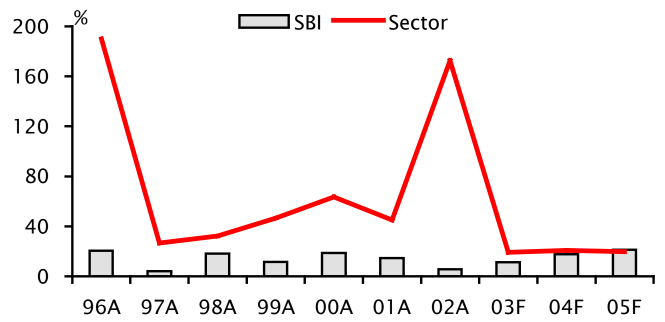
SBI has also been conservative in booking treasury profits in FY02. It has said it has an investment portfolio cushion that could withstand a 4ppt increase in yields.

We expect fee income to grow in future as government expenditure grows. The IT roll-out will also ease corporate servicing.

Financial analysis

Financial analysis (asset quality & provisions)

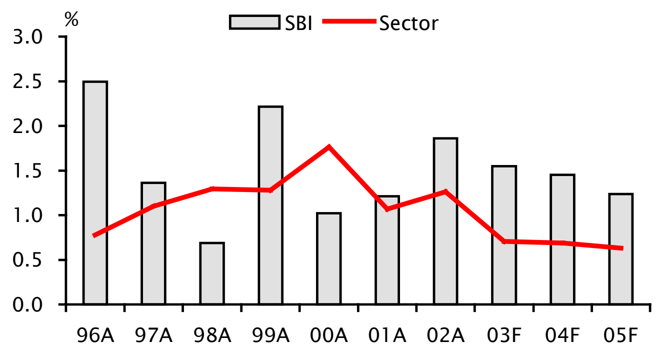
Loan growth



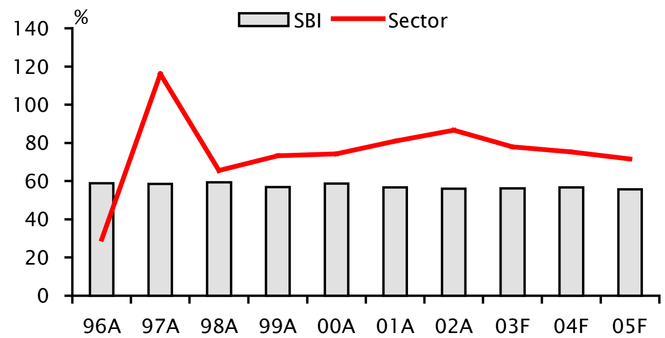
Risk-weighted assets growth (%)

	SBI	Sector	ICICI Bk	HDBk
2003F				
- Gross loans	11.2	19.4	9.6	26.9
- RWA	19.4	17.6	17.6	18.1
- Avg int earning asset	13.0	34.5	69.9	37.6
2004F				
- Gross loans	17.7	20.8	14.2	27.8
- RWA	14.8	19.6	23.2	21.0
- Avg int earning asset	12.5	15.3	6.3	25.4

Provision charge / average gross loans



Balance sheet provision/NPLs



Indian NPL norms and provisioning more lenient

Indian banks NPLs are calcualted on a 180-days interest past due basis cf. the international norm of 90 days. The 90 day norm will be effective from FY04, but banks have to start providing for it from FY02. SBI says the change will increase gross NPLs by only Rs10.9bn in FY02 (+7%). it has provided an extra Rs340m FY02 (Rs1bn total provision spread over three years). NPLs are classified into sub-standard (NPL for 18 mths), doubtful (NPL >18mths) and loss.

Provision requirements

General provisions of 0.25% on standard loans; substandard loans -10%; 20% <1 yr; 30% 1-3 yrs; 50% for 3 yrs+. 100% provision for loss loans.

Provisioning trend

Provision charge to average gross loans has increased in the last three years, as industrial growth has been slow and corporate NPLs increased. Perceived to be conservative in identifying and providing for NPLs cf. peers as RBI is majority shareholder.

All large banks have been affected by NPLs and higher provisions. Provisons to NPLs are lower than the sector, but in our opinion, ICICI Bank's coverage is significantly understated. Moreover, SBI has a higher component of NPLs prone to priority-sector segments cf. ICICI Bank and HDFC Bank. In the next three years, we expect SBI's provisions to average gross loans to be higher than the sector.

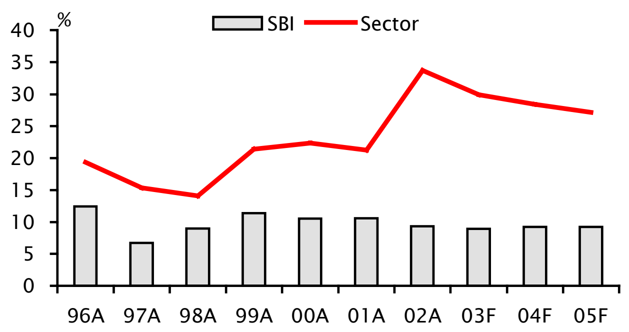
As SBI emphasises low-risk mortgages and has slowed corporate loans, we expect normalised provisions of 1.4% of average loans.

The government introduced a new bankruptcy law at end-Jun 02, though it still needs Parliamentary ratification within the next six months. This gives unprecendented powers to lenders to take over secured assets and dispose of them to recover bad loans. The new law should lower the risk perception of Indian banks and facilitate easier cash recovery from NPLs. However, industry associations have protested and the law may be watered down.

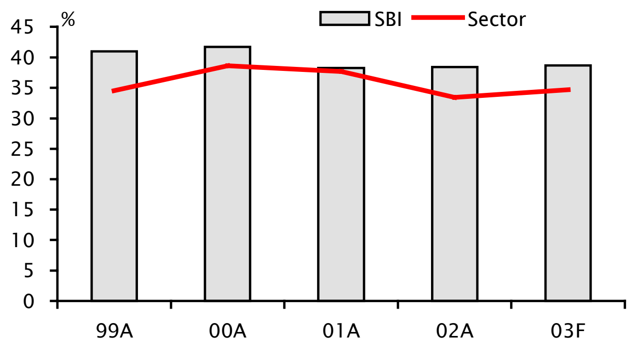
SBI's RWA growth would be lower than HDFC Bank and ICICI Bank as it starts form a higher base, but SBI would restrict itself to traditional loan assets. Mortgage growth will also be higher. We do not expect any significant rise in off-balance sheet volumes.

Financial analysis (funding & NIM)

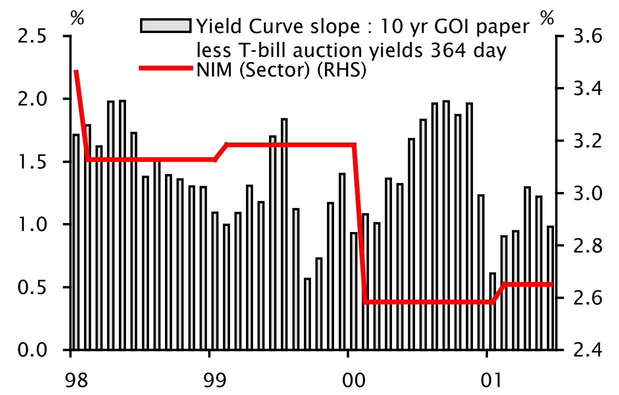
Borrowings & interbank liabilities / total borrowed funds



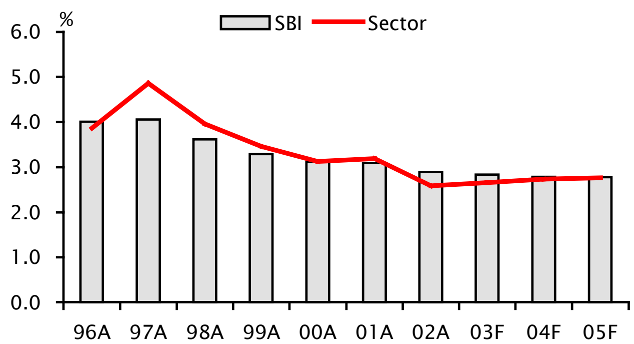
(Current + savings)/total customer deposits



Yield curve slope vs NIM (sector)



Net interest margin



Asset & liability management

Borrowings and interbank liabilities make up a relatively low proportion of total funding as its branch network garners low cost savings and current deposits.

Savings and current deposits to total deposits (ex RIB and IMDs) is 44% cf. HDFC Bank's 40% and ICICI Bank's 16%.

SBI has traditionally been a highly liquid bank and is normally a net lender in the interbank call market.

Stable interest rate outlook

In FY01, long-term yields on government paper fell c. 300bp, but have risen by c. 50bp since April 02.

The interest rate outlook for FY02 remains stable, though rates may decline marginally.

Liquidity for banks should remain comfortable as deposit growth is strong and credit continues to grow modestly.

Net interest margins

A declining interest rate environment hit margins more than other banks as SBI has longer tenor deposits.

Private banks like HDFC Bank and ICICI Bank emphasise low tenor deposits and discourage deposits of a higher tenor. ICICI Bank will however have to emphasise long tenor deposits on account of its merger with the pre-merged ICICI.

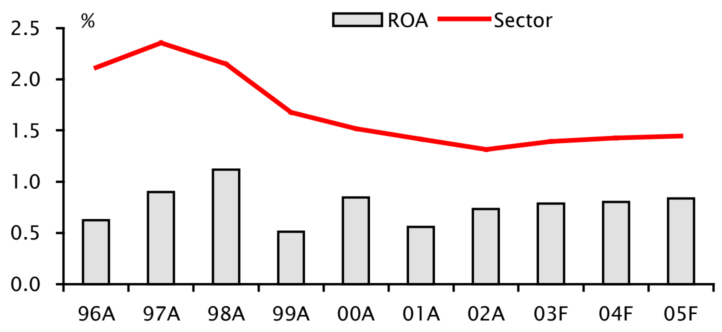
While SBI's interest margin has remained fairly stable in the last three years, HDFC Bank and ICICI Bank have come under greater pressure.

HDFC Bank's cost of funds has increased as its low cost deposits from the stock market have dried up, with low volumes in the capital market.

ICICI Bank's NIM was affected because of its merger with ICICI.

Financial analysis (capital management)

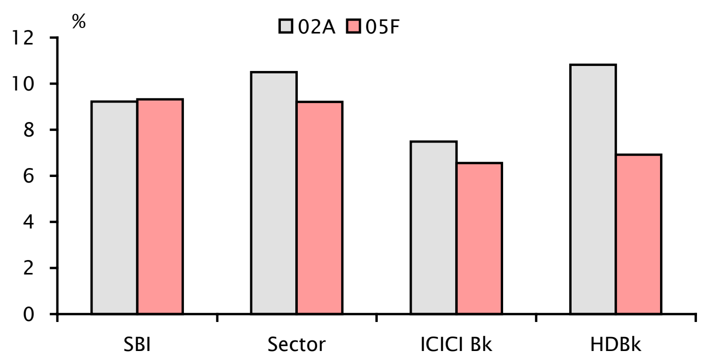
ROA



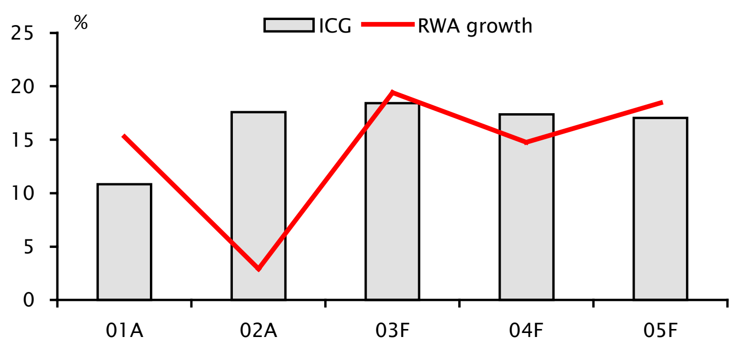
ROA

ROA should improve to 0.8% in FY04 from 0.73% in FY02. The main driver should be lower employee costs as headcount declines as staff hired >30 years ago retire.

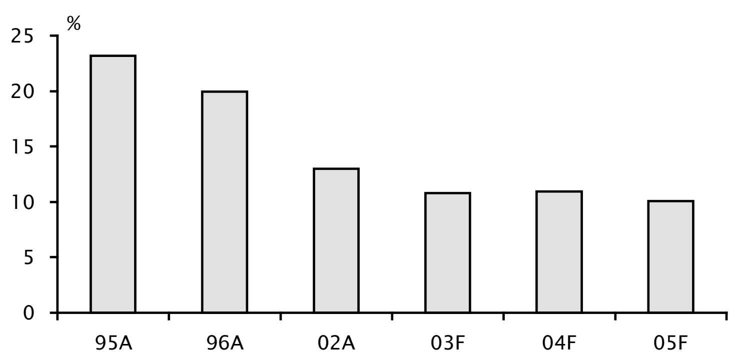
Tier-1 ratio (2002 & 2005)



Internal capital generation vs RWA growth



Payout ratio



Capital management and asset growth targets

SBI's Tier-1 capital has been lower than ICICI Bank and HDFC Bank as the private entities raised capital over the last two years.

SBI last raised equity in FY97. The current restriction on SBI raising capital is the RBI's holding, which is currently 59% but cannot go below 55%. SBI can increase Tier-1 capital by c. 1.4% without raising additional equity by transfering its hidden reserves to published reserves.

Given limited lending opportunities, most large banks growth in RWAs will lag behind growth in internal capital generation. This will lead to higher Tier-1 capital ratios as we estimate dividend payouts to remain at 11.5%.

According to SBI, minimum capital adequacy should be 12%, but we believe that Tier-1 capital should be a minimum 8.5%, given higher risk associated with the Indian economy.

Moreover because of the minimum RBI 55% holding, SBI is required to have higher internal capital generation to fund any growth in the economy when industrial production picks up.

SBI's dividend pay-out has declined from 23% in FY95 to 13%. We believe SBI has shored up its internal capital generation ina period of corporate restructuring and also contraints on raising equity capital. Apart from the minimum RBI 55% holding, the foreign holding in SBI has been capped at 20%, which was reached at the time of its GDR in FY97.

Financial analysis (balance sheet and financial stability measures)

10-year balance sheet analysis

Y/E Mar, Rsbn	96A	97A	98A	99A	00A	01A	02A	03F	04F	05F
Gross loans	661	687	811	904	1,071	1,226	1,295	1,440	1,694	2,054
Total provision o/s	62	64	68	80	90	90	87	90	93	97
Gross NPL	106	110	115	141	152	159	155	160	164	174
NPA (broadest definition)	106	110	115	141	152	164	168	173	178	189
Tot. assets ex-contras	1,445	1,565	1,797	2,225	2,615	3,142	3,472	3,968	4,392	5,016
Av. Int.-earning assets	1,179	1,322	1,493	1,844	2,220	2,671	3,140	3,549	3,992	4,496
Risk-weighted assets	643	802	765	934	1,226	1,413	1,454	1,736	1,993	2,361
o/w RWA equiv off bal sheet	–	–	–	–	–	–	–	–	–	–
Assets under management	–	–	–	–	–	–	–	–	–	–
Purchased goodwill o/s	–	–	–	–	–	–	–	–	–	–
Customer deposits	964	1,107	1,276	1,587	1,861	2,307	2,569	2,937	3,203	3,644
Shareholders funds	55	80	96	104	121	120	142	173	207	247
Unrealised capital gains	–	–	–	–	–	–	–	–	–	–
Tot. regulatory capital	75	98	112	117	142	181	194	204	228	257
Tier 1 capital	44	68	82	87	101	121	134	154	184	220
o/w hybrid Tier 1	–	–	–	–	–	–	–	–	–	–
Growth rates (%)										
Customer deposits	*13.2*	*14.8*	*15.3*	*24.4*	*17.3*	*23.9*	*11.4*	*14.3*	*9.1*	*13.8*
Loans (gross)	*20.6*	*4.0*	*18.0*	*11.5*	*18.5*	*14.5*	*5.6*	*11.2*	*17.7*	*21.2*
Av. int.-earning assets	*15.8*	*12.1*	*13.0*	*23.5*	*20.4*	*20.3*	*17.5*	*13.0*	*12.5*	*12.6*

Financial stability measures

Y/E March, (%)	96A	97A	98A	99A	00A	01A	02A	03F	04F	05F
Capital strength										
Total CAR	*11.6*	*12.2*	*14.6*	*12.5*	*11.6*	*12.8*	*12.9*	*11.7*	*11.4*	*10.9*
Tier-1 ratio	*6.9*	*8.5*	*10.7*	*9.4*	*8.3*	*8.6*	*9.2*	*8.9*	*9.2*	*9.3*
Int. cap. generat'n, ICG	*14.1*	*21.1*	*20.6*	*8.3*	*16.8*	*10.8*	*17.6*	*18.4*	*17.4*	*17.0*
Equity/total assets	*3.8*	*5.1*	*5.3*	*4.7*	*4.6*	*3.8*	*4.1*	*4.4*	*4.7*	*4.9*
Ext. cap raised as % sh equity	–	–	–	–	–	–	–	–	–	–
Asset quality & provisions										
Gross NPLs/gross loans	*16.0*	*16.0*	*14.1*	*15.6*	*14.2*	*12.9*	*12.0*	*11.1*	*9.7*	*8.5*
GP/gross loans	*3.1*	*2.9*	*2.6*	*2.2*	*1.8*	*2.1*	*1.9*	*1.7*	*1.5*	*1.3*
Total prov./gross NPLs	*59.0*	*58.7*	*59.5*	*57.0*	*58.8*	*56.8*	*56.0*	*56.2*	*56.7*	*55.6*
Prov. chrg./av.gross loans	*2.49*	*1.36*	*0.69*	*2.22*	*1.02*	*1.21*	*1.86*	*1.55*	*1.45*	*1.24*
Prov. chrg./pre-prov profit	*49.7*	*26.9*	*14.7*	*55.1*	*24.1*	*35.1*	*38.8*	*31.9*	*30.5*	*27.8*
Balance sheet structure										
Gross loans/tot. assets	*45.7*	*43.9*	*45.1*	*40.6*	*40.9*	*39.0*	*37.3*	*36.3*	*38.6*	*40.9*
Corp debt secur./tot.assets	*1.7*	*1.3*	*2.5*	*3.6*	*4.7*	*5.1*	*5.2*	*5.9*	*5.5*	*5.2*
LTD (customer only)	*68.5*	*62.0*	*63.5*	*56.9*	*57.5*	*53.1*	*50.4*	*49.0*	*52.9*	*56.4*
Cur. + sav. / cust. deposits	*45.4*	*44.9*	*44.7*	*41.0*	*41.7*	*38.2*	*38.4*	*38.7*	*40.8*	*41.2*
Deposits/borrowed funds	*87.6*	*93.3*	*91.0*	*88.6*	*89.5*	*89.4*	*90.7*	*91.1*	*90.8*	*90.8*
Housing/tot.cust.loans	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*4*	*6*	*9*	*11*	*14*
Cons. credit/tot. loans	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*7*	*7*	*8*	*8*	*8*
Prop. & constn./tot.loans	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Business mix (as % of total op. income)										
Net interest income	*63.2*	*66.8*	*65.6*	*64.9*	*66.0*	*67.2*	*68.5*	*68.9*	*69.0*	*69.0*
Net fees & commissions	*23.5*	*22.5*	*24.7*	*25.4*	*24.5*	*21.5*	*21.2*	*21.2*	*21.6*	*22.1*
Dealing profit	*12.5*	*8.7*	*6.1*	*6.1*	*3.1*	*2.5*	*3.1*	*3.0*	*3.0*	*2.9*
Mkt-related income (adj.)	*12.5*	*8.7*	*6.1*	*6.1*	*3.1*	*2.5*	*3.1*	*3.0*	*3.0*	*2.9*

Source: SG Research

Financial analysis (P&L and profitability & efficiency measures)

Profit & loss account (consolidated)

Y/E Mar, Rsbn	**96A**	**97A**	**98A**	**99A**	**00A**	**01A**	**02A**	**03F**	**04F**	**05F**
Net interest income	47	54	54	61	69	82	91	101	111	125
Fees (net) (see^)	18	18	20	24	26	26	28	31	35	40
Dealing profit	9	7	5	6	3	3	4	4	5	5
Other non-int. inc (see*)	1	2	3	3	7	11	10	10	10	11
Total operating income	75	80	82	93	105	123	133	146	161	181
Staff cost	(34)	(33)	(36)	(41)	(45)	(52)	(48)	(52)	(56)	(64)
Govt tax & levies	–	–	–	–	–	–	–	–	–	–
Restructuring costs	–	–	–	–	–	(9)	(4)	(4)	(4)	(4)
Other operating cost	(11)	(13)	(12)	(17)	(18)	(23)	(21)	(24)	(27)	(30)
Goodwill amortization	–	–	–	–	–	–	–	–	–	–
Total non-interest exp.	(45)	(46)	(47)	(59)	(63)	(83)	(72)	(79)	(86)	(97)
Pre-provision profits	30	34	35	35	42	40	60	66	75	84
Provision charges	(15)	(9)	(5)	(19)	(10)	(14)	(23)	(21)	(23)	(23)
Share of associates	–	–	–	–	–	–	–	–	–	–
Exceptionals (see*)	–	–	–	–	–	–	–	–	–	–
Pre-tax profits	15	25	30	16	32	26	37	45	52	60
Taxation	(7)	(11)	(11)	(5)	(11)	(10)	(13)	(16)	(18)	(21)
Minority int. - equity	–	–	–	–	–	–	–	–	–	–
Minority int. - non-equity	–	–	–	–	–	–	–	–	–	–
Attributable profits	8	14	19	10	21	16	24	29	34	39
^Market-related fees	–	–	–	–	–	–	–	–	–	–
*Secur gain as oth non-int inc	–	–	–	–	–	–	–	–	–	–
*Secur gain as exceptionals	–	–	–	–	–	–	–	–	–	–
Growth rates (%)										
Net interest income	*19.3*	*13.4*	*0.9*	*12.2*	*14.3*	*19.0*	*10.1*	*10.7*	*10.5*	*12.3*
Non interest income	*36.2*	*(3.2)*	*6.3*	*15.9*	*8.7*	*12.6*	*3.9*	*8.5*	*10.2*	*12.2*
Total operating costs	*23.3*	*3.4*	*2.5*	*24.9*	*6.8*	*31.8*	*(13.1)*	*10.1*	*8.6*	*12.7*
Pre-provision profits	*27.5*	*12.9*	*2.9*	*(1.9)*	*21.8*	*(5.6)*	*52.4*	*9.9*	*12.5*	*11.8*
Pre-tax profits	*13.1*	*64.1*	*20.1*	*(48.4)*	*105.8*	*(19.3)*	*43.7*	*22.2*	*14.9*	*16.2*
Attributable profits	*16.2*	*62.6*	*38.7*	*(45.2)*	*99.6*	*(21.8)*	*51.6*	*20.4*	*14.9*	*16.6*
EPS	*16.2*	*54.1*	*31.9*	*(45.2)*	*99.6*	*(21.8)*	*51.6*	*20.4*	*14.9*	*16.6*
DPS	–	*14.3*	–	–	*25.0*	–	*20.0*	–	*16.7*	*7.1*

Profitability & efficiency ratios

Y/E March, (%)	**96A**	**97A**	**98A**	**99A**	**00A**	**01A**	**02A**	**03F**	**04F**	**05F**
Margin, costs & efficiency										
Yield on earning assets	*10.99*	*11.31*	*10.63*	*10.36*	*10.00*	*9.73*	*9.49*	*9.21*	*9.27*	*9.24*
Av. cost of funds	*8.03*	*8.39*	*8.09*	*8.17*	*7.89*	*7.62*	*7.66*	*7.47*	*7.67*	*7.71*
Spread	*2.96*	*2.92*	*2.54*	*2.19*	*2.11*	*2.11*	*1.83*	*1.74*	*1.60*	*1.53*
Net interest margin	*4.01*	*4.05*	*3.62*	*3.29*	*3.12*	*3.09*	*2.89*	*2.83*	*2.78*	*2.77*
Compensation ratio	*44.8*	*41.4*	*43.2*	*44.4*	*42.7*	*42.1*	*36.2*	*35.5*	*34.6*	*35.1*
Cost-to-income ratio	*59.5*	*57.4*	*57.3*	*63.1*	*60.0*	*67.7*	*54.4*	*54.4*	*53.6*	*53.8*
o/w pre-GW & restruct.	*59.5*	*57.4*	*57.3*	*63.1*	*60.0*	*60.7*	*51.7*	*52.0*	*51.4*	*51.8*
Effective tax charge	*45.4*	*46.0*	*37.5*	*33.7*	*35.7*	*37.7*	*34.3*	*35.3*	*35.2*	*35.0*
Av. assets/av. Employee	0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.02	0.02	0.02
Employees (FTE, y/e)	233,000	236,000	239,649	237,504	232,494	214,845	209,462	207,362	204,662	201,162
Profitability										
ROE	*16.3*	*20.1*	*21.3*	*10.3*	*18.2*	*13.3*	*18.6*	*18.6*	*17.7*	*17.3*
ROA	*0.62*	*0.90*	*1.12*	*0.51*	*0.85*	*0.56*	*0.74*	*0.79*	*0.80*	*0.83*
RORWA	*1.36*	*1.87*	*2.39*	*1.21*	*1.90*	*1.22*	*1.70*	*1.84*	*1.80*	*1.80*

Source: SG Research

Qualitative analysis (management evaluation)

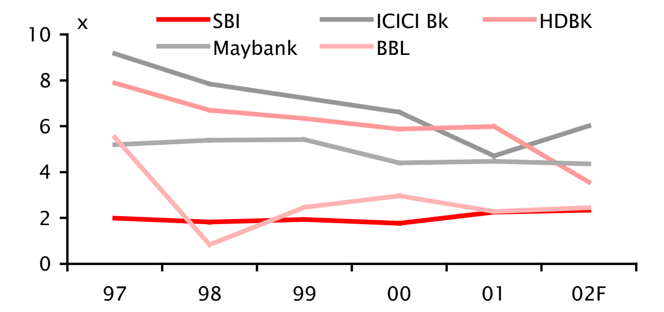
Total shareholders' returns

	Past 6M	Past 1 yr	Past 3 yr
SBI	31.7	11.9	8.4
ICICI Bk	58.6	9.2	295.0
HDBk	-9.3	-3.2	177.0
BBL	53.4	47.4	-30.4
Maybank	6.6	29.8	19.9

TSR = annualised capital appreciation + dividends

Source : Bloomberg

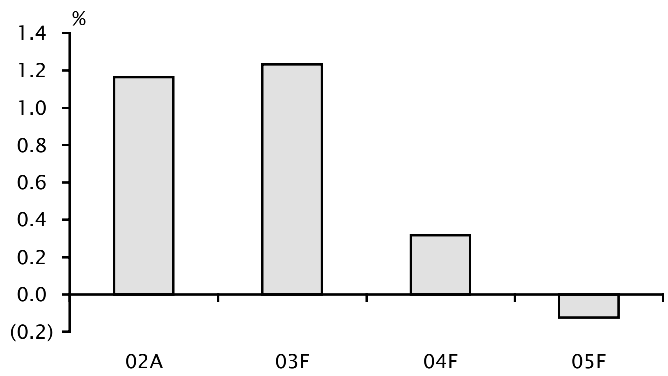
Return on investment in staff



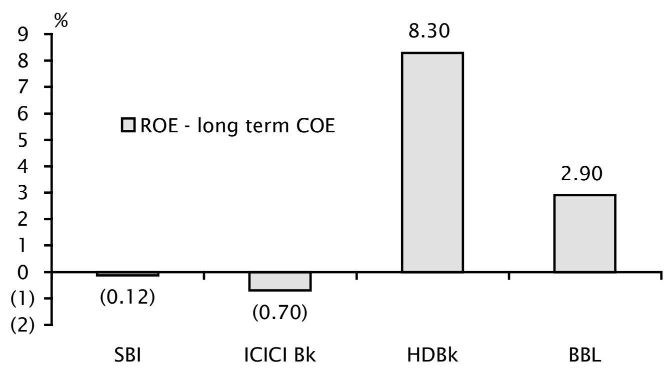
All Indian banks (Mar YE) are showing forecast one year ahead

ROI in staff = (Total op income less non-staff op expenses*) / staff costs (* excl GW)

Excess return equation (ROE - long-term COE)



Value creation versus peers (2005)



History of leadership change

Since 1993, SBI has had six executive chairman, sitting from anywhere between two months to two and a half years, as the government followed the principle of appointing the most senior executive to chairman.

The government changed this policy in Nov 00 by appointing the most senior executive for a minimum two year tenure. Currently, retirement age is 60, but considerations to change the term length are underway.

Existing Chairman Janki Ballabh retires on 30 Oct after two years. Durign his time he has focused on mortgages as a growth area to diversify risk and have quality asset growth.

So far, the mortgage strategy has been successful. In two yers SBI became the second largest mortgage financier.

One of the major reasons for SBI's derating is its government
label – compensation is fixed at similar levels as other government banks.

There is no monetary reward system for performers other than promotions and foreign postings.

The board cannot appoint executive directors or determine their remuneration.

SBI's appraisal system, however, is based on performance on how well budgeted targets have been met. While SBI cannot get rid of staff for non-performance their promotions can be held up.

SBI's IT plan envisages spending Rs5bn in the next three years on networking its major branches, setting up an ATM network and an ALM for its treasury.

Qualitative analysis

Qualitative analysis (corporate governance & risk factors)

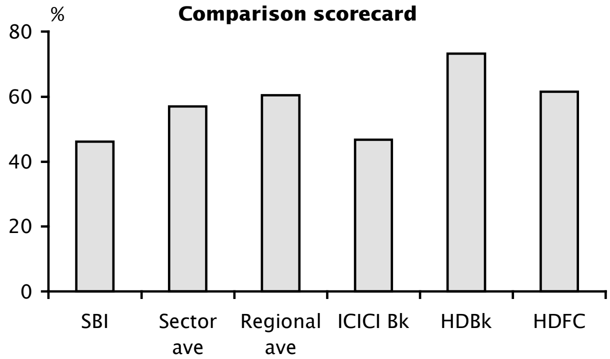
Corporate governance & disclosure

Yes = "x" implies positive; No = blank

1)	The bank scores well based on value creation?	
2)	Give clear forward-looking statements?	
3)	Consistently met / exceeded company set targets?	n/a
4)	Consistently created value through M&A, divestitures?	n/a
5)	Low risk of government interference?	
6)	Any management succession issues?	
7)	Disclosure of statistics beyond minimum required?	x
8)	Negative developments quickly disseminated?	x
9)	High degree of transparency?	
10)	IR function easily accessible & proactive?	x
11)	Provision policy stated clearly in annual report?	x
12)	Key breakdown information generally available?	
13)	Key data presented in clear and consistent format?	
14)	Strong brand recognition by general public?	x
15)	Strong brand recognition by large corporates?	x
	Total "Yes" score (%)	**46**

We rate SBI's corporate governance below its peers, due mainly to it being a government bank. The stock market penalises government companies across industries, despite SBI's fundamental strength. As the government appoints the CEO, there can be no succession planning.

Traditionally, SBI has been secretive, a trait probably inherited from the majority shareholder RBI. But in recent years, there has been considerable improvement in IR and disclosure above minimum requirements.



Operation & risks scores

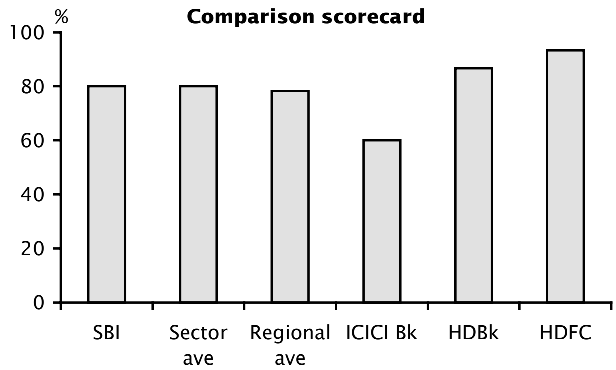
Yes = "x" implies low-risk; No = high risk

1)	Operating income as a % of assets healthy?	x
2)	CAR sufficient given the macro conditions?	x
3)	RWA fully funded by internal capital formation?	x
4)	Excessive growth in assets in riskier areas?	x
5)	Possibility of dividend cut?	x
6)	Profits volatile - dependent on financial markets?	x
7)	Off balance sheet activities too opaque?	x
8)	Excess reliance on wholesale / overseas funding?	x
9)	Exceptional items: both large & unpredictable?	x
10)	Excess loan concentration to risky sectors?	x
11)	Prudence in recognising NPLs?	
12)	Prudence in loan loss provisions?	
13)	Prudence in revaluation of collateral values?	
14)	Cost growth generally within control?	x
15)	Low staff turnover & good labour relationship?	x
	Total "Yes" score (%)	**80**

SBI scores high on operational and risk scores because it has strong fundamentals and is run on prudent banking principles. Its scores are higher than ICICI Bank but lower than HDFC Bank and HDFC.

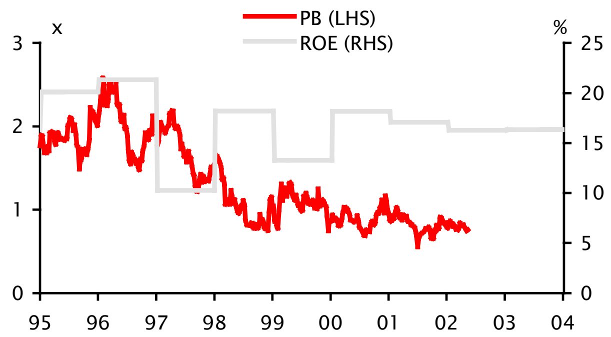
ICICI Bank suffered from its merger with parent ICICI, while HDFC Bank was set up in the early 1990s and was not burdened with politically directed lending or with the task of national development.

In the banking sector, SBI towers above the rest not only in size but also in health.

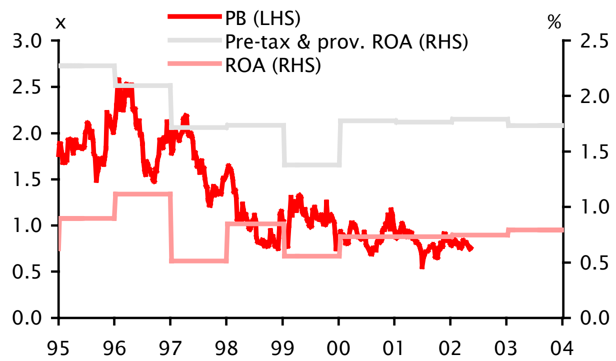


Valuation analysis (PB valuation)

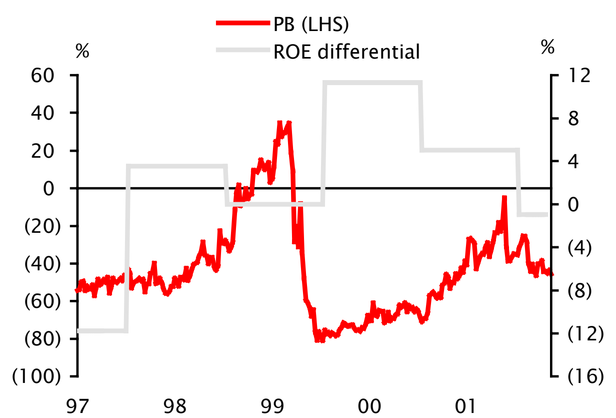
P/B versus forward ROE



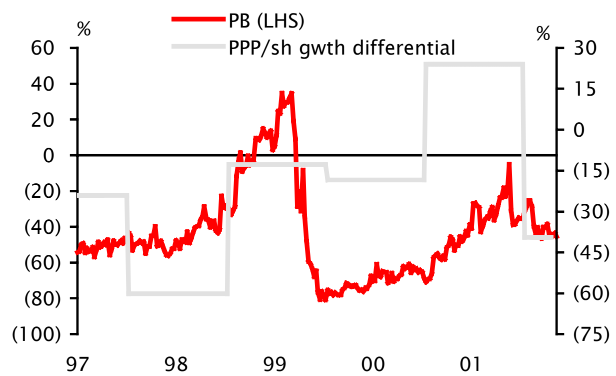
P/B versus forward ROA



P/B premium and ROE differential (SBI vs ICICIBk)



P/B premium vs PPP/ps growth differential



Drivers of PB Multiples

SBI has been de-rated despite growing book value and consistent and rising dividends. The reasons for the de-rating are general disinterest in government-owned/managed companies, the lack of technology cf. newer banks and the foreign holdings cap.

We believe a re-rating is eminent as SBI has finally made a start in its technology roll-out by installing ATMs, networking key branches and offering internet banking. Products will not only be supported by a technology backbone but will be cheaper than rivals due to lower cost of funds.
SBI's bloated workforce was reduced by c. 9% in FY01 and will continue to decline as more employees retire. Finally, the foreign-holding cap, in our view, should be relaxed as the policy is now inconsistent with the changing economic environment. e.g. ICICI Bank's foreign holding is 44%.

A major positive that could help a re-rating is a pick up in overall economic activity, vs just pockets of credit growth in mortgages and other retail loans. Although there are some flickers light, a broad-based recovery is not yet visible.

PB valuation has been more influenced by the 1-year forward ROA than with 1-year forward ROE. As natural attrition reduces headcount, employee cost reductions will be the major contributor to improved ROA.

PB discount to peers

SBI has traditionally traded at a discount to the old (prior to the merger) ICICI Bank, except for a brief period in FY99.

With the merger of ICICI with ICICI Bank, we believe SBI's discount is unjustified.

ICICI Bank has been considerably weakened by the merger in terms of solvency and liquiditiy.

We believe that ICICI Bank's asset quality is far worse than it reports and is significantly higher than market concensus.

SBI's fundamentals, in our view, are far superior to ICICI Bank and its accounting policies more conservative.

The market has already reduced the discount between SBI and ICICI Bank following the merger, but we believe SBI should trade at a premium to ICICI Bank.

Valuation analysis (alternative valuation tools)

PB & other valuation tools

	Period	SBI	Sector	ICICI Bk	HDBk
PB (x)	03F	0.71	1.81	1.24	2.90
PE (x)	03F	4.2	10.5	9.5	16.7
MktCap/PPP (x)	03F	1.8	6.9	6.1	10.3
EPS growth (%)	03F	20.4	18.8	22.9	14.5
EPS growth (%)	04F	14.9	21.8	40.3	16.9
ROE (%)	03F - 05F	17.9	19.0	16.4	20.1
Yield (%)	03F	2.6	2.0	1.7	1.3

Other valuation benchmarks

On all parameters SBI trades at a significant discount to ICICI Bank and HDFC Bank. The problem with SBI's valuation is its government ownership and its relative inflexibility in restructuring its operations. The foreign-ownership cap has also depressed valuation. Even on a regional basis, SBI's valuation is attractive.

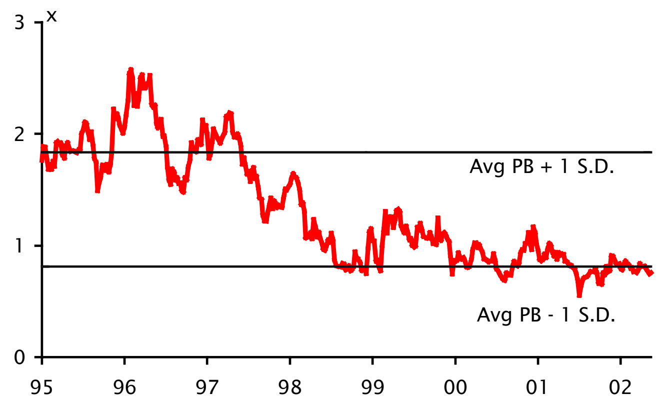
On market cap to deposits, SBI is extremely attractive considering it is India's largest bank, with 20% market share. Its low-cost deposits arelower than HDFC Bank because its deposits include large foreign borrowings. Even excluding these, low-cost deposits would exceed HDFC Bank's.

Fee income to deposits is higher than HDFC Bank but lower than ICICI Bank. In our opinion, the quality of SBI's fee income is superior to the other banks as it includes a high proportion of fees from non-fund based business like handling government transactions and remittances. This provides float funds. In other banks fee income is linked to potential risk weighted assets in the form of guarantees and letters of credit.

Market cap / deposits vs peers

	Period	SBI	Sector	ICICI Bk	HDBk
Mkt cap to deposits (%)	03F	4.1	31.0	20.6	27.1
Cur.+sav./cust. deposits (%)	02A	38.4	33.4	19.3	42.5
Fees/deposits (%)	03F - 05F	1.14	1.61	2.55	1.10
ROA (%)	03F - 05F	0.81	1.42	1.07	1.23

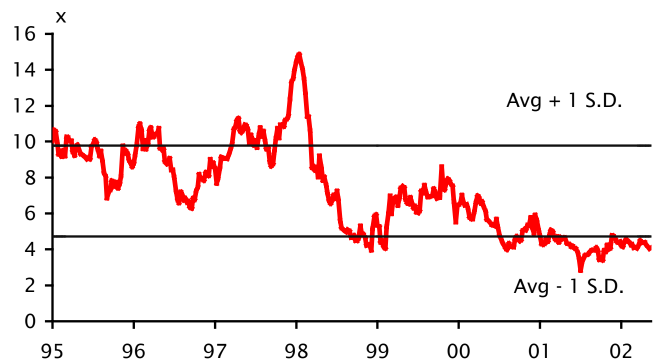
PB band - standard deviation



PB and PE Band

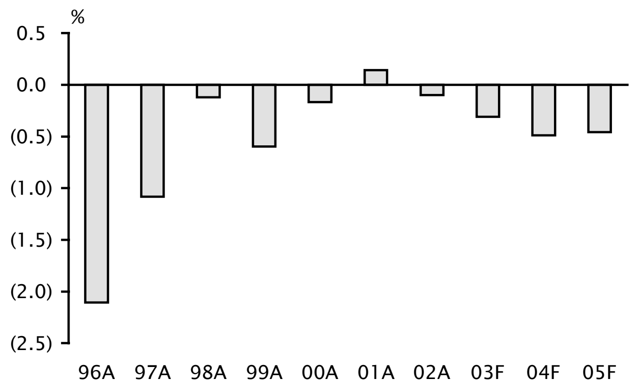
Current PB is undemanding relative to its historic average and with other private banks, as SBI has been de-rated.

PE band

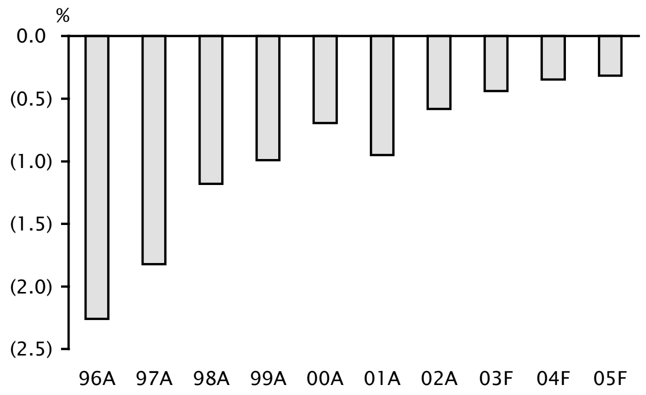


Valuation analysis (fundamentals)

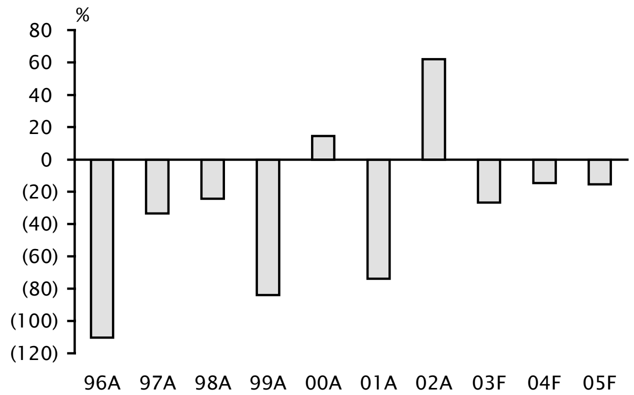
ROE premium/(discount) vs ICICI Bk



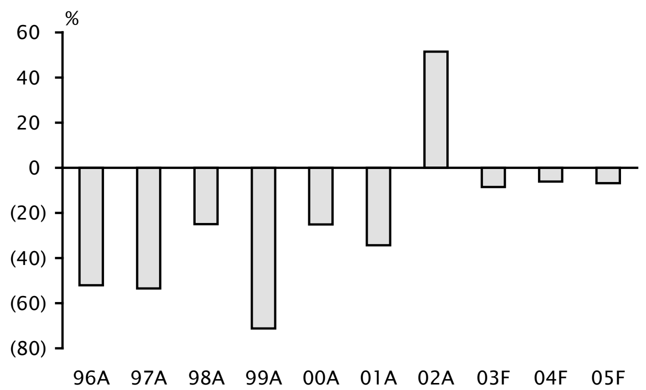
ROE premium/(discount) vs HDBk



PPP/sh growth premium/(discount) vs ICICI Bk



PPP/sh growth premium/(discount) vs HDBk



Risk measures vs peers

All fig. In %	Period	SBI	Sector	ICICI Bk	HDBk
Operating leverage*	03F - 05F	53.9	44.3	53.4	53.3
Provision charge/PPP	03F - 05F	30.1	14.6	13.2	10.8
Coverage ratio ^	03F - 05F	56.2	74.9	60.0	65.0
Gross NPL / tot loans	02A	12.0	7.4	13.5	3.2
Gross NPL / tot loans	03F	11.1	6.9	12.8	2.9
Net NPL / equity	02A	48.1	30.3	41.0	1.8
Net NPL / equity	03F	40.5	29.2	42.6	4.4
Net NPA / equity	02A	57.4	27.4	0.0	0.0

* Cost(ex GW)/Income (ex Secur Inv) ^ Total prov./gross NPLs

^ Net NPA / equity = [non-performing assets (= NPL + rescheduled loans) - bal sheet prov] / equity

Growth measures vs peers

All fig. In CAGR %	Period	SBI	Sector	ICICI Bk	HDBk
Op expense growth	99A - 02A	6.9	10.7	95.8	67.6
Op expense growth	02A - 05F	10.5	17.6	63.6	32.9
PPP/sh growth	99A - 02A	20.5	24.6	48.6	47.3
PPP/sh growth	02A - 05F	11.4	13.0	16.2	12.3
EPS growth	99A - 02A	33.3	28.8	45.1	38.7
EPS growth	02A - 05F	17.3	18.2	30.6	16.3
BVPS growth	99A - 02A	10.8	18.4	76.0	60.0
BVPS growth	02A - 05F	20.4	16.5	14.1	3.2

Two-stage model valuation and implied PB

	Recom.	Stage 1 EPS grth (%)	DPS Growth Stage 1 (%)	DPS Growth Stage 2 (%)	ROE Stage 1 (%)	ROE Stage 2 (%)	COE (SG est.) (%)	Jun-03 BVPS	Fair P/B x	Effective premium/ (discount)	Target price (Rs)	Implied target P/B (x)
SBI	BUY	9.3	17.1	9.0	15.5	17.5	16.9	413	0.81	0.0	335	0.81
ICBK	U/P	11.8	21.9	9.0	15.1	19.5	20.4	115	0.95	0.0	109	0.95
HDFC	U/P	9.1	14.0	9.0	18.3	16.9	13.9	270	1.94	13.3	595	2.20
HDBK	U/P	11.7	18.5	9.0	17.5	17.4	14.4	73	2.09	0.0	154	2.09

Source: SG Research

Valuation analysis

Valuation analysis (regional comparisons)

Matrix - part I

Banks	Local recom.	Regional weighting	Latest year-end	Market cap	Price 2 Aug 02	Target price	Fwd PB target	PB latest time wt.	PE 12 mth fwd	Mkt cap / deposits FY 02	ROE FY 02	ROE FY 03
				(US$ bn)	(Loc cur)	(Jun 02)	(X)	(X)	(X)	(%)	(%)	(%)
Hong Kong												
HSBC	H	N	Dec-01	104.9	87.5	96.0	2.4	2.2	15.2	*23.3*	*13.5*	*15.0*
HSB	H	N	Dec-01	21.0	85.8	89.5	3.7	3.6	15.8	*41.4*	*22.4*	*23.0*
BEA	B	O/W	Dec-01	2.7	14.9	20.5	1.5	1.1	11.1	*15.1*	*9.1*	*10.4*
WLB	H	U/W	Dec-01	0.9	31.2	38.7	1.1	0.9	8.9	*14.6*	*9.6*	*10.5*
WHB	B	N	Dec-01	0.9	24.5	31.0	1.4	1.1	8.7	*15.7*	*11.4*	*13.2*
DSF	H	U/W	Dec-01	1.1	34.6	38.6	1.5	1.5	9.4	*25.8*	*14.1*	*15.7*
JCG	H	U/W -	Dec-01	0.3	3.8	4.2	0.8	0.8	8.6	*n/m*	*7.7*	*9.7*
India												
SBI	B	O/W	Mar-02	2.5	228	335	0.9	0.8	4.5	*4.7*	*15.8*	*17.7*
ICICI Bk	U-P	U/W	Mar-02	1.8	145	104	0.9	1.4	10.0	*32.8*	*18.9*	*17.0*
HDFC	U-P	N	Mar-02	1.6	640	595	2.2	2.7	13.1	*89.8*	*20.7*	*21.8*
HDBK	U-P	U/W	Mar-02	1.2	210	154	2.1	3.0	17.2	*35.1*	*23.7*	*19.8*
Korea												
Kookmin	B	O/W	Dec-01	14.8	55,000	84,400	2.3	1.7	7.6	*15.3*	*22.3*	*21.5*
Chohung	H	N	Dec-01	2.9	5,020	7,230	1.3	1.1	4.2	*9.3*	*18.1*	*29.8*
Shinhan	B	O/W	Dec-01	4.0	16,250	27,500	2.0	1.3	5.9	*15.1*	*18.1*	*21.2*
Hana	B	N	Dec-01	2.0	17,050	25,200	1.5	1.2	5.2	*7.4*	*20.3*	*22.5*
Koram	U-P	U/W-	Dec-01	1.5	9,970	14,000	1.9	1.4	5.4	*11.1*	*26.3*	*26.2*
Malaysia												
Maybank	H	N	Jun-01	8.2	8.8	10.4	2.9	2.7	16.7	*31.8*	*15.1*	*14.7*
CAHB	B	O/W	Dec-01	2.8	8.2	10.2	1.9	1.6	13.6	*22.5*	*10.0*	*12.3*
RHBC	U-P	U/W-	Jun-01	1.1	2.2	2.4	1.2	1.1	13.6	*10.3*	*5.2*	*7.4*
Public (for)	B	O/W	Dec-01	3.4	2.8	3.3	1.8	2.0	15.2	*32.6*	*11.9*	*13.4*
AMMBH	H	N	Mar-02	1.2	5.0	6.0	1.7	1.6	12.1	*14.2*	*12.4*	*12.7*
Singapore												
DBS	H	U/W	Dec-01	10.6	12.1	13.6	1.3	1.2	13.5	*22.0*	*8.7*	*10.0*
UOB	B	O/W	Dec-01	11.7	13.0	15.1	1.7	1.6	15.6	*26.9*	*8.5*	*10.2*
OCBC	H	U/W-	Dec-01	8.4	11.4	12.2	1.6	1.6	16.1	*26.3*	*8.8*	*10.1*
Thailand												
BBL (for)	B	O/W	Dec-01	2.4	67.5	90.0	2.6	2.2	12.8	*9.2*	*14.2*	*16.8*
KTB	H	U/W	Dec-01	2.8	10.7	11.0	1.9	1.9	14.1	*13.8*	*12.5*	*12.9*
TFB (for)	S	U/W	Dec-01	1.6	29.3	28.0	2.1	2.3	11.0	*10.4*	*17.0*	*19.8*
SCB (for)	H	N	Dec-01	1.9	25.5	27.0	1.1	1.5	29.0	*13.3*	*1.6*	*5.7*
IFCT	B	O/W	Dec-01	0.2	6.8	9.0	1.3	1.0	20.5	*n/m*	*2.2*	*5.9*
AEONTS	ST BUY	O/W	Feb-02	0.2	199.0	300.0	9.1	5.7	13.1	*n/m*	*36.7*	*38.3*
SG universe average ratio (unweighted)							***1.7***	***1.7***	***12.4***	***22.3***	***13.9***	***15.4***

All Indian banks & AMMB Hldg(Mar YE) and Maybank & RHB (Jun YE) are showing forecast one year ahead of the others banks in this table.
For Thai & Singapore banks (where dilution could be substantial), P/B is calculated from FD BVPS. For Korea Banks ABVPS are adjusted to exclude government preference stock which are closer to bonds in nature.
ST BUY: STRONG BUY, B: BUY, H: HOLD, U: U-P, S: SELL
O/W + : Heavily overweight; O/W : moderately overweight; N : neutral; U/W : moderate underweight; U/W - : significantly underweight, zero : zero weightings
Source: SG Research

Valuation analysis (regional comparisons)

Matrix - part 2

Banks	Total assets	Capital strength FY 02			Assets quality FY 02			Business & rev mix FY 02		P&L - 3yr CAGR FY 01 - 04		Profitability FY 02		
		Total CAR	Tier1 ratio	ICG	NPL ratio	NPL coverage	Prov chrg./ av. loans	LTD ratio	Non-int inc/ op inc	Pre-prov profits	EPS	Net int margin	Cost/ Income	ROA
	(US$ bn)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Hong Kong														
HSBC	686.5	13.3	9.8	3.8	3.2	89.9	0.5	69.1	43.6	3.9	n/m	2.44	59.3	1.05
HSB	60.9	15.4	12.4	1.6	2.3	55.6	0.3	59.9	29.2	4.3	3.6	2.42	24.0	2.14
BEA	23.3	17.8	12.9	4.6	2.7	68.7	0.5	82.1	28.3	12.0	13.9	2.17	51.6	0.93
WLB	8.3	21.5	18.1	6.1	3.3	81.8	0.5	60.4	25.7	1.6	3.2	1.83	32.4	1.14
WHB	7.1	17.0	15.7	6.2	3.5	54.7	1.3	79.3	20.8	5.6	10.2	2.73	31.8	1.25
DSF	7.0	19.0	14.7	8.8	2.3	96.6	1.9	86.4	25.1	7.5	6.5	3.38	38.7	1.42
JCG	0.6	85.4	83.3	3.4	7.5	119.1	12.5	314.7	18.5	0.7	2.9	17.83	20.3	5.57
India														
SBI	71.4	11.7	8.9	18.4	11.1	56.2	1.6	49.0	31.1	23.5	17.3	2.8	54.4	0.79
ICICI Bk	21.4	10.7	6.9	11.9	12.8	60.0	0.4	138.0	52.7	86.3	30.6	1.4	54.1	0.83
HDFC	4.7	14.7	14.7	16.7	0.9	130.5	0.2	221.8	26.7	17.9	15.9	3.0	15.8	2.63
HDBK	4.9	12.1	9.6	14.1	2.9	65.0	0.7	40.7	27.3	21.1	16.3	3.4	51.6	1.32
Korea														
Kookmin	132.5	10.6	7.5	18.5	5.9	45.0	1.0	100.3	34.3	30.0	20.5	3.75	37.4	1.31
Chohung	46.5	10.9	6.9	20.9	8.2	42.8	2.4	99.5	57.0	10.4	22.9	2.13	36.3	0.91
Shinhan	47.6	11.8	8.3	13.7	4.3	44.2	1.0	117.1	38.3	20.8	25.6	2.58	36.5	1.02
Hana	38.2	6.0	3.8	18.7	4.2	34.7	0.7	108.6	30.1	14.6	20.3	2.30	34.5	0.79
Koram	24.0	7.5	5.0	21.8	4.8	51.8	0.6	131.1	50.6	15.1	21.9	1.96	41.4	1.05
Malaysia														
Maybank	38.5	15.9	11.1	12.5	17.8	53.0	0.9	114.3	31.8	3.7	33.1	2.98	36.9	1.27
CAHB	19.6	11.8	10.7	9.4	11.4	45.1	1.3	96.3	28.4	7.8	37.3	2.79	41.6	0.83
RHBC	15.1	12.2	10.5	3.4	15.5	48.8	1.7	104.9	26.5	-2.2	17.5	3.03	40.8	0.61
Public (for)	14.0	22.7	21.1	4.2	7.3	51.5	0.9	82.4	28.2	3.1	9.6	3.57	40.2	1.68
AMMBH	14.5	11.9	7.7	13.3	27.5	33.5	0.9	141.5	40.7	-1.8	33.4	2.45	55.1	0.82
Singapore														
DBS	86.4	17.4	11.9	5.9	6.5	61.5	0.4	66.1	35.2	5.1	11.7	1.96	53.8	0.87
UOB	48.7	19.8	13.2	4.8	9.2	65.2	0.3	84.2	33.1	17.5	10.8	1.85	47.2	0.96
OCBC	48.7	19.6	11.5	5.7	9.6	64.0	0.9	93.3	32.4	1.2	12.1	1.99	41.6	0.93
Thailand														
BBL (for)	29.7	12.4	7.4	14.8	18.4	46.9	0.8	65.0	32.6	20.4	17.0	2.02	68.5	0.50
KTB	23.2	15.1	13.0	10.7	15.9	16.6	0.1	82.0	23.1	37.4	n/m	2.02	65.8	0.77
TFB (for)	18.4	14.4	8.5	18.5	15.2	40.5	0.2	73.0	36.9	24.7	100.7	2.03	72.5	0.65
SCB (for)	17.0	16.4	10.1	1.6	19.5	26.1	2.2	75.0	32.4	10.2	43.9	2.41	57.3	0.14
IFCT	4.6	9.5	5.2	2.2	15.2	34.6	0.3	n/a	85.9	191.2	n/m	0.11	54.9	0.09
AEONTS	0.2	n/a	n/a	31.8	2.2	159.4	4.3	n/a	2.7	41.6	33.9	25.71	59.8	3.76
SG universe average ratio (unweighted)					**9.4**	**56.0**	**0.9**	**93.4**	**34.9**	**n/m**	**n/m**	**2.4**	**45.2**	**1.0**

All Indian banks & AMMB Hldg(Mar YE) and Maybank & RHB (Jun YE) are showing forecast one year ahead of the others banks in this table.
Source: SG Research

Appendix 1: infopage

Balance sheet (consolidated)

Y/E Mar, Rsbn	01A	02A	03F	04F	05F
Key items					
Gross loans	1,226	1,295	1,440	1,694	2,054
Total provision o/s	90	87	90	93	97
Gross NPL	159	155	160	164	174
NPA (broadest defination)	164	168	173	178	189
Tot. assets ex-contras	3,142	3,472	3,968	4,392	5,016
Av. Int.-earning assets	2,671	3,140	3,549	3,992	4,496
Risk-weighted assets	1,413	1,454	1,736	1,993	2,361
o/w RWA equiv off bal sheet	-	-	-	-	-
Assets under management	-	-	-	-	-
Purchased goodwill o/s	-	-	-	-	-
Customer deposits	2,307	2,569	2,937	3,203	3,644
Shareholders funds	120	142	173	207	247
Unrealised capital gains	-	-	-	-	-
Tot. regulatory capital	181	194	204	228	257
Tier 1 capital	121	134	154	184	220
o/w hybrid Tier 1	-	-	-	-	-
Growth rates (%)					
Customer deposits	*23.9*	*11.4*	*14.3*	*9.1*	*13.8*
Loans (gross)	*14.5*	*5.6*	*11.2*	*17.7*	*21.2*
Av. int.-earning assets	*20.3*	*17.5*	*13.0*	*12.5*	*12.6*

Financial stability measures

Y/E March, (%)	01A	02A	03F	04F	05F
Capital strength					
Total CAR	*12.8*	*12.9*	*11.7*	*11.4*	*10.9*
Tier-1 ratio	*8.6*	*9.2*	*8.9*	*9.2*	*9.3*
Int. cap. generat'n, ICG	*10.8*	*17.6*	*18.4*	*17.4*	*17.0*
Equity/total assets	*3.8*	*4.1*	*4.4*	*4.7*	*4.9*
Ext. cap raised as % sh equity	-	-	-	-	-
Asset quality & provisions					
Gross NPLs/gross loans	*12.9*	*12.0*	*11.1*	*9.7*	*8.5*
GP/gross loans	*2.1*	*1.9*	*1.7*	*1.5*	*1.3*
Total prov./gross NPLs	*56.8*	*56.0*	*56.2*	*56.7*	*55.6*
Prov. chrg./av.gross loans	*1.21*	*1.86*	*1.55*	*1.45*	*1.24*
Prov. chrg./pre-prov profit	*35.1*	*38.8*	*31.9*	*30.5*	*27.8*
Balance sheet strucutre					
Gross loans/tot. assets	*39.0*	*37.3*	*36.3*	*38.6*	*40.9*
Corp debt secur./tot.assets	*5.1*	*5.2*	*5.9*	*5.5*	*5.2*
LTD (customer only)	*53.1*	*50.4*	*49.0*	*52.9*	*56.4*
Cur. + sav. / cust. deposits	*38.2*	*38.4*	*38.7*	*40.8*	*41.2*
Deposits/borrowed funds	*89.4*	*90.7*	*91.1*	*90.8*	*90.8*
Housing/tot.cust.loans	*4*	*6*	*9*	*11*	*14*
Cons. credit/tot. loans	*7*	*7*	*8*	*8*	*8*
Prop. & constn./tot.loans	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
Business mix (as % of total op. income)					
Net interest income	*67.2*	*68.5*	*68.9*	*69.0*	*69.0*
Net fees & commissions	*21.5*	*21.2*	*21.2*	*21.6*	*22.1*
Dealing profit	*2.5*	*3.1*	*3.0*	*3.0*	*2.9*
Mkt-related income (adj.)	*2.5*	*3.1*	*3.0*	*3.0*	*2.9*

Share data

Y/E March, Rs		01A	02A	03F	04F	05F
EPS	Rs, adj	30.48	46.22	55.63	63.93	74.54
FD EPS	Rs, adj	30.48	46.22	55.63	63.93	74.54
DPS	Rs, adj	5.00	6.00	6.00	7.00	7.50
BV PS	Rs, adj	228.8	269.1	328.0	393.6	469.3
FD BV PS	Rs, adj	n/a	n/a	n/a	n/a	n/a
ABV PS	Rs, adj	n/a	n/a	n/a	n/a	n/a
Y/e shares, adj (m)		526	526	526	526	526
Adj av. shares, m		526	526	526	526	526
Enlarged shares, m		526	526	526	526	526

Capital structure & miscellaneous

Ordinary Shares (m):	526.299 (Rs0 share)			
Board lot:	1			
Preference Shares (m):	0			
Capital changes:				
Date	Type	Proceeds	Shares after, m	Adj.
4-Oct-96	GDR	13,137.0	526.3	-
Major shareholders:	RBI (59.7%)			
	0			
Results due:	Interim: Qtly; Final: Mar			

Profit & loss account (consolidated)

Y/E Mar, Rsbn	01A	02A	03F	04F	05F
Key items					
Net interest income	82	91	101	111	125
Fees (net) (see=)	26	28	31	35	40
Dealing profit	3	4	4	5	5
Other non-int. inc (see*)	11	10	10	10	11
Total operating income	123	133	146	161	181
Staff cost	(52)	(48)	(52)	(56)	(64)
Govt tax & levies	-	-	-	-	-
Restructuring costs	(9)	(4)	(4)	(4)	(4)
Other operating cost	(23)	(21)	(24)	(27)	(30)
Goodwill amortization	-	-	-	-	-
Total non-interest exp.	(83)	(72)	(79)	(86)	(97)
Pre-provision profits	40	60	66	75	84
Provision charges	(14)	(23)	(21)	(23)	(23)
Share of associates	-	-	-	-	-
Exceptionals (see*)	-	-	-	-	-
Pre-tax profits	26	37	45	52	60
Taxation	(10)	(13)	(16)	(18)	(21)
Minority int. - equity	-	-	-	-	-
Minority int. - non-equity	-	-	-	-	-
Attributable profits	16	24	29	34	39
=Market-related fees	-	-	-	-	-
*Secur gain as oth non-int inc	-	-	-	-	-
*Secur gain as exceptionals	-	-	-	-	-
Growth rates (%)					
Net interest income	*19.0*	*10.1*	*10.7*	*10.5*	*12.3*
Non interest income	*12.6*	*3.9*	*8.5*	*10.2*	*12.2*
Total operating costs	*31.8*	*(13.1)*	*10.1*	*8.6*	*12.7*
Pre-provision profits	*(5.6)*	*52.4*	*9.9*	*12.5*	*11.8*
Pre-tax profits	*(19.3)*	*43.7*	*22.2*	*14.9*	*16.2*
Attributable profits	*(21.8)*	*51.6*	*20.4*	*14.9*	*16.6*
EPS	*(21.8)*	*51.6*	*20.4*	*14.9*	*16.6*
DPS	*0.0*	*20.0*	*0.0*	*16.7*	*7.1*

Profitability & efficiency ratios

Y/E March, (%)	01A	02A	03F	04F	05F
Margin, costs & efficiency					
Yield on earning assets	*9.73*	*9.49*	*9.21*	*9.27*	*9.24*
Av. cost of funds	*7.62*	*7.66*	*7.47*	*7.67*	*7.71*
Spread	*2.11*	*1.83*	*1.74*	*1.60*	*1.53*
Net interest margin	*3.09*	*2.89*	*2.83*	*2.78*	*2.77*
Compensation ratio	*42.1*	*36.2*	*35.5*	*34.6*	*35.1*
Cost-to-income ratio	*67.7*	*54.4*	*54.4*	*53.6*	*53.8*
o/w pre-GW & restruct.	*60.7*	*51.7*	*52.0*	*51.4*	*51.8*
Effective tax charge	*37.7*	*34.3*	*35.3*	*35.2*	*35.0*
Av. assets/av. Employee	0.01	0.02	0.02	0.02	0.02
Employees (FTE, y/e)	214,845	209,462	207,362	204,662	201,162
Profitability					
ROE	*13.3*	*18.6*	*18.6*	*17.7*	*17.3*
ROA	*0.56*	*0.74*	*0.79*	*0.80*	*0.83*
RORWA	*1.22*	*1.70*	*1.84*	*1.80*	*1.80*
Component analysis of ROA					
Net interest income	*2.87*	*2.75*	*2.70*	*2.66*	*2.65*
Non interest income	*1.40*	*1.26*	*1.22*	*1.19*	*1.19*
Tot. non-interest exp.	*(2.88)*	*(2.18)*	*(2.13)*	*(2.06)*	*(2.07)*
Pre-provision profits	*1.38*	*1.83*	*1.79*	*1.79*	*1.78*
Provision charges	*(0.48)*	*(0.71)*	*(0.57)*	*(0.55)*	*(0.49)*
Assocs & exceptionals	-	-	-	-	-
Taxation	*(0.34)*	*(0.38)*	*(0.43)*	*(0.44)*	*(0.45)*
Net profit + MI P&L	*0.56*	*0.74*	*0.79*	*0.80*	*0.83*

Half-yearly breakdown

Y/E Mar, Rsbn	1H01	2H01	1H02	2H02	% HoH
Net interest income	39	44	43	48	10.1
Non interest income	17	23	20	22	8.3
Total non-interest exp.	(34)	(49)	(34)	(38)	10.6
Pre-provision profits	22	17	29	31	8.3
Provision charges	(7)	(7)	(9)	(14)	56.5
Attributable profit	10	6	12	12	(1.2)

Dividend data

Gross dividend, Rs	Amount	Ex-date	Books close	Payment
FY02	6.00			

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Appendix 2: foreclosure ordinance

The government introduced the "Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance" on 21 Jun 02. In the next six months the ordinance has to be ratified by Parliament. By promulgating it as an ordinance, the government has given high priority to securitisation, asset reconstruction and foreclosure – an area neglected since independence. From a legal viewpoint, powers have been given to banks to take over defaulting assets and dispose them without a court order.

The ordinance has three parts:

- Setting up asset reconstruction and securitisation companies (ARCs). ARCs will have minimum capital of Rs20m and maximum capital of 15% of financial assets acquired. To be regulated and registered by the RBI.
- Enforcement of Security interest. Once a loan becomes an NPL, the bank can give 60 days notice, failing which the bank can enforce security by taking possession of the secured asset or taking over management of the security. Defaulting borrowers can appeal to the Debt Recovery Tribunals (DRTs), but the DRT will not entertain the appeal unless the borrower deposits 75% of the outstanding amount. The secured lender can use the Chief Metropolitan Magistrate (CMM) or District Magistrate (DM) to take possession of the security and no authority can dispute the actions of the CMM and DM. It also appears that this ordinance will supersede existing bankruptcy laws like the Board for Industrial and Financial Reconstruction (BIFR) and Sick Industries Companies Act (SICA), under which defaulting companies have sought shelter.
- Setting up a central registry for the purpose of registration of securitisation and reconstruction of financial assets and creation of security interest.

The new ordinance is revolutionary in the sense that lenders have been given sweeping powers for foreclosure of defaulting assets. Under the earlier system, creditors required court orders to take possession of defaulting assets and the process got bogged down for years in the courts, by which time realisable value of the security had eroded. The ordinance, once passed into law by Parliament, should prevent borrowers from defaulting on loans and help banks reduce their NPLs through recoveries and less slippage.

However, the implementation of the ordinance may take some time because:

- The corporate lobby wants dilution of the ordinance. Corporates are worried about the stringent provisions in the ordinance and we expect strong lobbying to dilute some of the more onerous provisions. Many companies benefited from the old system as banks were unable to foreclose defaulting loans. More importantly, banks were rarely able to dislodge existing management and defaulting promoters. This ordinance gives the banks power to usurp management of defaulting companies.
- Banks/creditors may not be willing to take action against politically strong companies. It is interesting to note that for State Finance Corps (SFCs) the enforcement of security that this ordinance provides for banks exists in Section 29 of the SFC Act, 1951. But they have been unable to foreclose loans of any significant amount because defaulters are either politicians or have strong political connections. Typically in India, when banks have taken strong action against powerful parties, political pressure is applied on banks to back off. This ordinance cannot neutralise such pressures.

- Banks are waiting for standardised rules from the government and RBI for implementing the ordinance. The absence of which, banks claim, would lead to unnecessary litigation. The rules are expected to take some time before finalisation, as the RBI has to set up a committee to examine these issues.
- Even if creditors are able to smoothly take possession of the security, finding a buyer could be difficult. Some of the recovery staff we contacted in banks mentioned that finding buyers for plant and machinery could be trying.

While these concerns may cause some delays in foreclosures, the fact remains that the newly introduced ordinance is an extremely powerful tool in recovering NPLs. We view this ordinance as a major positive development for the banking sector, which has long been plagued with poor NPL recovery. Already there are media reports that ICICI Bank has served borrowers with notices under this ordinance while SBI and Industrial Development Bank of India (IDBI) are also planning to serve notices to some of their defaulting borrowers.

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