Equity
Research

Equity Research Report Banks

Date: March 25, 2019

State Bank of India

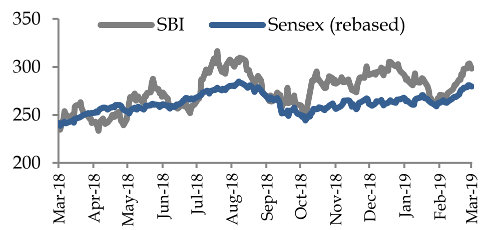
Analyst Recommendation: BUY

BSE Code:	500112	NSE:	SBIN	Reuters Code:	SBI.NS	Bloomberg Code:	SBIN:IN

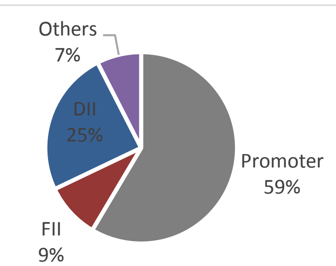
CMP:	**Rs 298**
1 Year Target -	**Rs 345**

Face Value	1.0
Market Cap (Rscr)	266,042
52 week high/low	326/232
Avg. Daily Volume (6m)	2.3 Cr
Shares O/S (Cr)	892.5
Book Value per Share (Rs)	245.5
Sensex	38,165
Nifty	11,457

1 yr. Price Chart of Stock and BSE



Shareholding pattern as on 30th June 2018



Investor's Rationale

- **Loan book to grow at a healthy pace supported by domestic retail credit:** Loan growth was higher at 12% YoY in Q3FY19 mainly led by 16% YoY growth in the domestic loans (92% of the total loan book). Within domestic credit, corporate advances grew by 21% YoY largely driven by the infrastructure sector (↑20% YoY). Retail segment continued exhibiting strong growth (↑18% YoY) led by robust growth in home loans (↑26.5% YoY). SME continued to grow at a slower pace of 8% YoY as the bank remained cautious in lending to SME after witnessing high levels of stress from this segment. Going forward, we expect advances to grow at a moderate CAGR of 10% over FY18-21E led by healthy momentum in domestic loan growth.

- **Improving core operating performance:** Net interest income (NII) increased at a strong pace of 21% YoY (in line with our expectation) in Q3FY19 supported by healthy loan growth and 34 bps YoY improvement in net interest margin (NIM) to 3.0%. We expect NIM to improve to 3.2% by FY21E on the back of NCLT resolutions, asset re-pricing and the improving credit to deposit (C-D) ratio. Provisions declined sharply (↓68% YoY) led by a sharp reversal in investment MTM provisions of Rs7,994cr. This boosted PAT to Rs3,954cr as compared to loss in Q3FY18. We expect operating profit to grow at a CAGR of 10% over FY18-21E supported by improving NIM coupled with higher other income.

- **Asset quality improvement on track:** On asset quality front, the bank surprised positively in Q3FY19 as it reported lowest slippages of Rs6,500cr in the past 13 quarters. Of the total fresh slippages, the corporate segment accounted for 29% and the rest were from SME (35%), agri (25%) and retail (11%). Lower slippages coupled with higher write-offs helped the bank to report improved asset quality ratios. Hence, Gross and Net non-performing asset (NPA) ratios improved by 124 bps and 89 bps sequentially to 8.7% and 4.0%, respectively. Notably, SBI's aggregate NCLT exposure stands at Rs44,300cr (24% of Gross NPA), with a coverage of ~75%. Besides, the management expects a recovery from 8 a/cs (of which 5 are NCLT cases) with a total exposure of Rs34,000cr in the near term. Hence, we believe asset quality improvement is imminent and project Gross/Net NPA ratios will moderate to 6.9%/3.5% by FY21E.

Valuation: SBI, given the improving overall credit growth and a possible shift of business from NBFCs, is best placed to ride this opportunity. We reiterate it as our top pick amongst PSU banks. Overall, the long-term structural value of the bank remains intact and we expect RoE and RoA to improve to 11.2% and 0.7%, respectively by FY21E as asset quality pressure abates and revenue growth momentum remains strong. Hence, we recommend BUY rating on the stock with a target price (TP) of Rs345 using the sum of the parts (SOTP) methodology, where we value its standalone business at Rs276 (P/ABV of 1.4x for FY21E) and subsidiaries at Rs69. Resolution of stressed power assets and select NCLT-referred accounts remains the key near-term monitorable.

	FY18	FY19E	FY20E	FY21E
Net Int. Income	74,854	86,731	98,359	113,092
Pre Pro Profit	59,511	56,181	67,157	77,206
Net Profit	(6,547)	3,877	22,359	28,305
EPS	(7.7)	4.3	25.1	31.7
P/E	-	68.6	11.9	9.4
P/BV	1.2	1.2	1.1	1.0
P/ABV	2.5	2.1	1.8	1.5
RoE (%)	-	1.8	9.6	11.2
RoA (%)	-	0.1	0.6	0.7

Loan book to grow at a healthy pace supported by domestic retail credit

Loan growth was higher at 12% YoY in Q3FY19 mainly led by 16% YoY growth in the domestic loans (92% of the total loan book). Within domestic credit, corporate advances grew by 21% YoY largely driven by the infrastructure sector (↑20% YoY). Retail segment continued exhibiting strong growth (↑18% YoY) led by robust growth in home loans (↑26.5% YoY). SME continued to grow at a slower pace of 8% YoY as the bank remained cautious in lending to SME after witnessing high levels of stress from this segment. Going forward, we expect advances to grow at a moderate CAGR of 10% over FY18-21E led by healthy momentum in domestic loan growth.

Improving core operating performance

Net interest income (NII) increased at a strong pace of 21% YoY (in line with our expectation) in Q3FY19 supported by healthy loan growth and 34 bps YoY improvement in net interest margin (NIM) to 3.0%. We expect NIM to improve to 3.2% by FY21E on the back of NCLT resolutions, asset re-pricing and the improving credit to deposit (C-D) ratio. Cost to income (C/I) ratio deteriorated sharply (↑282 bps YoY) mainly due to elevated operating expenses (↑21% YoY) along with flat other income (↓1% YoY). Employee expenses increased by 31% YoY as the bank recognised the unamortised liability on the enhancement of gratuity limits. Provisions declined sharply (↓68% YoY) led by a sharp reversal in investment MTM provisions of Rs7,994cr. This boosted PAT to Rs3,954cr as compared to loss in Q3FY18. We expect operating profit to grow at a CAGR of 10% over FY18-21E supported by improving NIM coupled with higher other income.

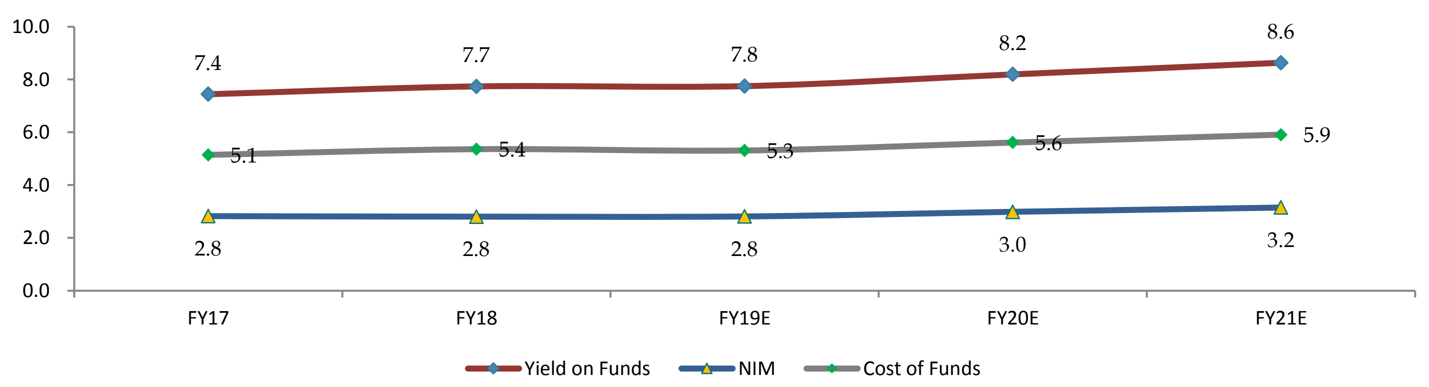
Asset quality improvement on track

On asset quality front, the bank surprised positively in Q3FY19 as it reported lowest slippages of Rs6,500cr in the past 13 quarters. Of the total fresh slippages, the corporate segment accounted for 29% and the rest were from SME (35%), agri (25%) and retail (11%). Lower slippages coupled with higher write-offs helped the bank to report improved asset quality ratios. Hence, Gross and Net non-performing asset (NPA) ratios improved by 124 bps and 89 bps sequentially to 8.7% and 4.0%, respectively. Higher NPA provisions helped the provision coverage ratio (PCR) to improve by 389 bps QoQ to 75%. Notably, SBI's aggregate NCLT exposure stands at Rs44,300cr (24% of Gross NPA), with a coverage of ~75%. Besides, the management expects a recovery from 8 a/cs (of which 5 are NCLT cases) with a total exposure of Rs34,000cr in the near term. Hence, we believe asset quality improvement is imminent and project Gross/Net NPA ratios will moderate to 6.9%/3.5% by FY21E.

Return ratios to improve

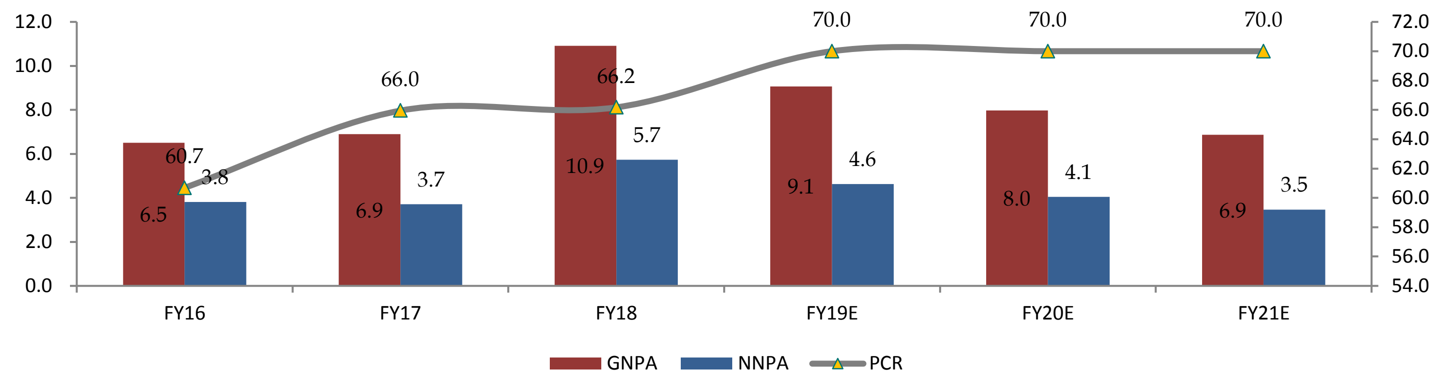
SBI's return ratios remained under pressure on the back of higher operating expenses coupled with higher credit cost due to deteriorating asset quality. However, the bank has taken several measures to improve its operating efficiency. The bank moved its overseas treasury operations to centralized location from 21 locations which helped the bank to reduce its treasury operations cost. Going forward, we expect net profit to gain strong traction aided by controlled credit cost and lower C/I ratio of ~52% by FY21E. It will also help the bank to improve its RoE to11.2% and RoA to 0.7% by FY21E.

NIM to improve to ~3.2% by FY21E

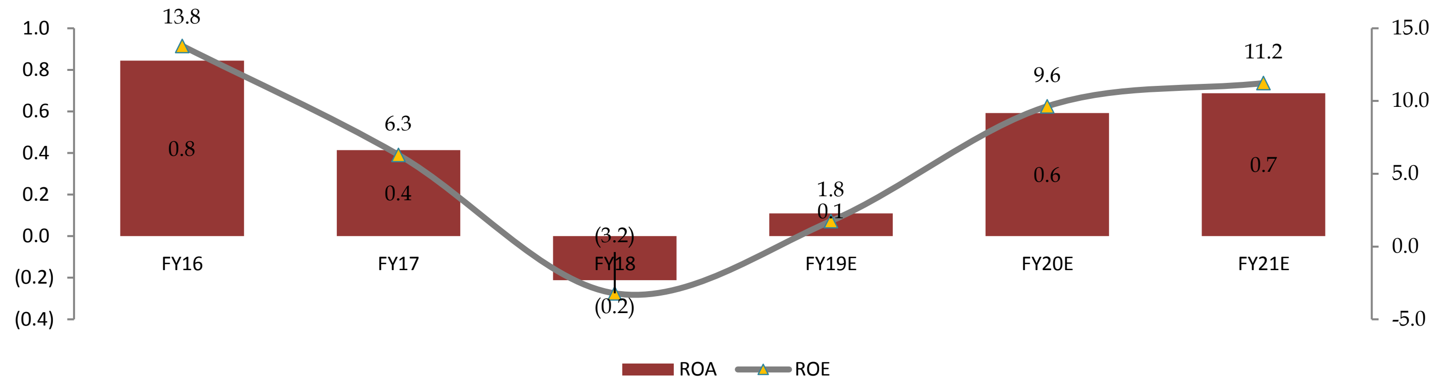


Source: Company, In-house research

Asset quality to improve gradually over FY18-21E



Return ratios to improve gradually over FY18-20E



Source: Company, In-house research

Outlook and Valuation

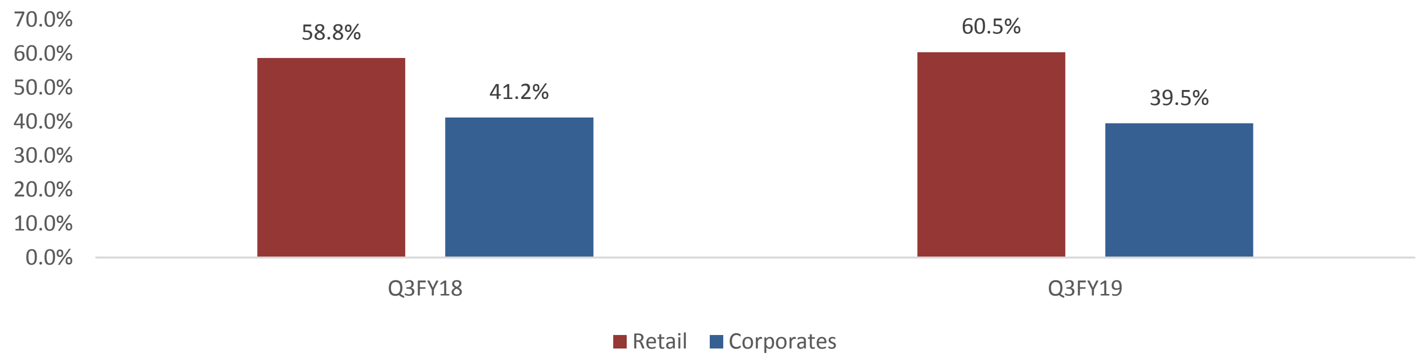
SBI, given the improving overall credit growth and a possible shift of business from NBFCs, is best placed to ride this opportunity. We reiterate it as our top pick amongst PSU banks. Overall, the long-term structural value of the bank remains intact and we expect RoE and RoA to improve to 11.2% and 0.7%, respectively by FY21E as asset quality pressure abates and revenue growth momentum remains strong. Hence, we recommend BUY rating on the stock with a target price (TP) of Rs345 using the sum of the parts (SOTP) methodology, where we value its standalone business at Rs276 (P/ABV of 1.4x for FY21E) and subsidiaries at Rs69. Resolution of stressed power assets and select NCLT-referred accounts remains the key near-term monitorable.

State Bank of India: Business overview

SBI is India's largest commercial bank with balance sheet size of Rs~35tn and a market cap of Rs2.5tn. It has nearly 22,090 branches on standalone basis. While the bank has well distribution network in rural and semi-urban areas with around 65% of total branches, SBI has also presence in 36 overseas countries with 200 branches. Further, SBI is India's largest commercial Bank not only in terms of assets but also in terms of deposits, profits, branches, number of customers and employees.

The bank offers the entire spectrum of financial services to customer segments covering Large and Mid-Corporates, MSME, Agriculture and Retail Businesses. However, over the past two years, the bank has sharpened focus on retail credit to provide itself the necessary growth momentum and improve spreads. Going forward, growth in retail advances is likely to be driven by improving economic condition as well as initiatives taken by SBI to attract retail customers. It includes more emphasizes on mobile banking, online customer acquisition system and launches of digitalized InTouch branches, which are completely sales outfits and helping the bank to enhances the home and auto loans.

Business mix shifting in favour of retail segment



Source: Company, In-house research

Quarterly Financials (Standalone)

Rs (cr)	Q3FY19	Q3FY18	YoY Growth %	Q2FY19	QoQ Growth %
Interest Income	62,277	54,803	13.6	58,793	5.9
Interest Expense	39,586	36,115	9.6	37,888	4.5
Net Interest Income	**22,691**	**18,688**	**21.4**	**20,906**	**8.5**
Non-Interest Income	8,035	8,084	(0.6)	7,815	2.8
Total Net Income	30,726	26,772	14.8	28,720	7.0
Operating Expenses	18,101	15,017	20.5	16,376	10.5
Employee Cost	11,172	8,497	31.5	9,696	15.2
Other Operating Exp.	6,929	6,520	6.3	6,680	3.7
Total Income	70,312	62,887	11.8	66,608	5.6
Total Expenditure	57,687	51,132	12.8	54,264	6.3
Pre-Provisioning profit	**12,625**	**11,755**	**7.4**	**12,344**	**2.3**
Provisions	6,006	18,876	(68.2)	12,092	(50.3)
Profit Before Tax	6,619	(7,122)	-	1,813	265.1
Tax	2,664	(4,705)	-	868	207.0
Net Profit	**3,955**	**(2,416)**	**-**	**945**	**318.6**
EPS - Diluted (Rs)	4.4	(2.8)	-	1.1	317.9

Business Performance (Rs cr)

(Rs cr)	Q3FY19	Q3FY18	YoY Growth %	Q2FY19	QoQ Growth %
Advances	2,047,779	1,826,212	12.1	1,957,340	4.6
Deposits	2,830,538	2,651,240	6.8	2,807,420	0.8
Business	**4,878,317**	**4,477,452**	**9.0**	**4,764,760**	**2.4**
Gross NPA	187,765	199,141	(5.7)	205,864	(8.8)
Net NPA	80,944	102,370	(20.9)	94,810	(14.6)

Key Risks

- **Exposure to high leveraged sectors:** SBI diversified its loan portfolio across sectors and segments, however bank exposure to sectors like power, steel, telecom and roads & ports remained high. Thus, subdued economic recovery further poses the risk on assets quality front.
- **Lower growth than expected:** We expect loan growth of 10% over FY18-21E largely led by higher growth in retail assets. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.

Balance Sheet (Standalone)

(Rs crore)	FY18	FY19E	FY20E	FY21E
Liabilities				
Capital	892	892	892	892
Reserves & Surplus	218,236	222,113	239,831	262,335
Deposits	2,706,343	2,929,909	3,212,916	3,559,256
Borrowings	362,142	301,599	269,984	281,881
Other Liabilities & Provisions	167,138	176,688	190,383	209,910
Total Liabilities	**3,454,752**	**3,631,202**	**3,914,006**	**4,314,274**
Assets				
Cash & Balances	191,899	202,094	217,815	240,219
Investments	1,060,987	1,087,050	1,124,521	1,245,739
Advances	1,934,880	2,079,996	2,287,996	2,516,795
Fixed Assets	39,992	39,992	39,992	39,992
Other Assets	226,994	222,070	243,682	271,528
Total Assets	**3,454,752**	**3,631,202**	**3,914,006**	**4,314,274**

(Rs crore)	FY18	FY19E	FY20E	FY21E
Interest Income	220,499	254,108	286,818	329,647
Interest Expense	145,646	167,377	188,459	216,556
Net Interest Income	**74,854**	**86,731**	**98,359**	**113,092**
Non-Interest Income	44,601	38,116	43,023	49,447
Net Income	119,454	124,848	141,382	162,539
Operating Expenses	59,943	68,666	74,226	85,333
Total Income	265,100	292,225	329,841	379,095
Total Expenditure	205,589	236,043	262,684	301,889
Pre-Provisioning Profit	**59,511**	**56,181**	**67,157**	**77,206**
Provisions	75,039	50,307	33,280	34,320
Profit Before Tax	(15,528)	5,875	33,877	42,886
Tax	(8,981)	1,997	11,518	14,581
Net Profit	**(6,547)**	**3,877**	**22,359**	**28,305**

Key Ratios & Valuations (Standalone)

Y.E. March	FY18	FY19E	FY20E	FY21E
EPS	(7.7)	4.3	25.1	31.7
DPS	0.0	0.0	0.0	0.0
BV	245.5	249.9	269.7	294.9
ABV	121.3	142.0	165.9	197.3
Valuation (%)				
P/E	-	68.6	11.9	9.4
P/BV	1.2	1.2	1.1	1.0
P/ABV	2.5	2.1	1.8	1.5
Div. Yield	0.0	0.0	0.0	0.0
Spreads (%)				
Yield on Advances	8.1	8.1	8.6	9.1
Yield on Investments	7.7	7.7	8.2	8.7
Yield on Funds	7.7	7.8	8.2	8.6
Cost of Funds	5.4	5.3	5.6	5.9
Capital (%)				
CAR	12.6	12.3	12.3	12.2
Tier I	10.4	10.0	10.0	10.0
Tier II	2.2	2.2	2.2	2.2
Asset (%)				
GNPA	10.9	9.1	8.0	6.9
NNPA	5.7	4.6	4.1	3.5
PCR	66.2	70.0	70.0	70.0
Management (%)				
Credit/ Deposit	71.5	71.0	71.2	70.7
Cost/ Income	50.2	55.0	52.5	52.5
CASA	44.5	44.9	44.7	44.1
Earnings (%)				
NIM	2.8	2.8	3.0	3.2
ROE	-	1.8	9.6	11.2
ROA	-	0.1	0.6	0.7

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Between 10% & -5%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -5%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.*

** State Bank of India is a Large-cap bank.*

Member: BSE, NSE, MCX, MCX-SX, CDSL

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