Sharekhan
by BNP PARIBAS

State Bank of India

Asset-quality performance enthuses

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 319**	
Price Target: **Rs. 415**	↑

↑ Upgrade ↔ No change ↓ Downgrade

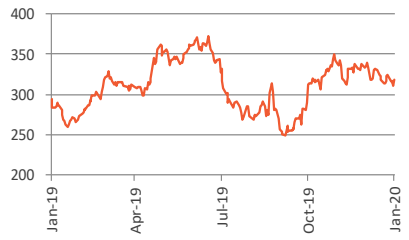
Company details

Market cap:	Rs. 2,84,294 cr
52-week high/low:	Rs. 374/244
NSE volume: (No of shares)	261.1 lakh
BSE code:	500112
NSE code:	SBIN
Sharekhan code:	SBIN
Free float: (No of shares)	382.6 cr

Shareholding (%)

Promoters	57.9
FII	11.0
DII	24.3
Others	6.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.6	11.8	-8.0	11.9
Relative to Sensex	-5.2	7.1	-15.2	-3.7

Sharekhan Research, Bloomberg

State Bank of India (SBI's) Q3 results had several moving parts with slippages, divergences and recoveries. However, on the whole, the lender reported healthy performance for Q3 FY2020. Net interest income (NII) increased by 22.4% y-o-y (versus our expectation of 16.9% y-o-y) as domestic net interest margin (DNIM) improved to 3.59%, (up by 62 bps y-o-y and 37 bps q-o-q). As a result, profit after tax (PAT) increased to Rs. 5,523 crore, rising by 42% y-o-y and was better than expectations. During the quarter, SBI exercised the option of a lower tax rate taking a one-time hit of Rs. 1,333 crore. Excluding the impact of this hit, net profit would have been Rs. 6,916 crore. Asset quality performance was encouraging, as net non-performing asset (NPA) ratio stood at 2.65% (down 130 bps y-o-y and 14 bps q-o-q), while the gross NPA ratio came in at 6.94% (down 177 bps y-o-y and 25 bps q-o-q). Slippages amounted to Rs 16,525 crore (which includes exposure to a large HFC of ~Rs. 7000 crore). Domestic loan growth, however, was soft owing to weak credit offtake from corporates and for FY20E too, loan growth is expected to be on similar lines. The management exuded confidence about NIMs and asset quality performance going forward, and a healthy provisioning cover (PCR at whopping 81.7%) on the balance sheet are comforting factors. We introduce FY22E estimates and accordingly rollover the price target. We maintain our Buy rating on the stock with a revised PT of Rs. 415.

Key positives

- Asset quality performance was encouraging, with net NPA ratio dropping by 130 bps y-o-y and 14 bps q-o-q to 2.65% while the gross NPA ratio fell by 177 bps y-o-y and 25 bps q-o-q to 6.94%.
- Domestic net interest margin (DNIM) improved to 3.59%, (up by 62 bps y-o-y and 37 bps q-o-q) helped by Interest income of Rs. 4,000 crore due to recoveries.

Key negatives

- Total loan book growth was tepid of 6.8% y-o-y mainly as the corporate segment's credit offtake remains muted

Our Call

Valuation: SBI currently trades at 1.1 x its FY2022E book value, which we believe is reasonable considering an improving balance sheet strength and robust capitalisation. We believe that an improving asset-quality outlook, balance sheet strength, strong capitalization and strong operating metrics are key positives for it. We have introduced FY22E estimates and accordingly rollover the price target. We maintain our Buy rating on the stock with a revised PT of Rs. 415.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/ or retail segments due to the overall macroeconomic slowdown would affect profitability.

Valuation — Rs cr

Particulars	FY19	FY20E	FY21E	FY22E
Net interest income	88,349	1,02,605	1,17,155	1,35,256
Net profit	862	16,200	27,787	33,964
EPS (Rs)	1.0	18.2	31.1	38.1
PE (x)	291.5	17.6	10.2	8.4
Book value (Rs/share)	213.3	227.2	251.0	280.2
P/BV (x)	1.5	1.4	1.3	1.1
RoE (%)	0.4	7.1	11.4	12.7
RoA (%)	0.0	0.4	0.7	0.7

Source: Company; Sharekhan estimates

Key concall highlights

- **Digitalisation:** Around 63% of accounts today are being opened on YONO. The cost / income benefit from digitalisation is not visible as yet, but is expected to reflect on numbers in due course of time.
- **Subsidiaries:** Most subsidiaries like the AMC, life insurance business, etc are already doing well.
- Apart from mostly retirement related costs other costs, including wage costs are well under control.
- SBI plans to launch a massive (HR) reorganization from May 2020, which will lead to a visible improvement in customer service and the capability to compete in Micro and retail markets.
- Exposure to a troubled HFC is ~Rs 10,000 crore (bond + loans). SBI has already set aside 30% of provisions. Already expression of interest (EOI) bids are being invited and are expected to be resolved within 12 months. The exposure will necessitate further provision in Q4. The bank expects a 40% recovery potential in the HFC account.
- SBI has 32 cases of Inter Creditor Agreements (ICAs), of which eight are fully resolved, nine are in NCLT (additional provision requirement is Rs. 1,100 crore). Apart from that, ageing related provision will be there. The bank expects provision of Rs 10,000 crore for Q4.
- Interest write-backs amounted to Rs. 4,000 crore. Provision write-backs stood at Rs. 7,800 crore. International exposure of Rs. 1,500 crore was to the HFC account as mentioned above.
- Non funded + funded exposure to a wind power borrower will be resolved soon
- O/s Security receipts (SR) book is of worth Rs. 7,700 crore.
- **Developer guarantee scheme:** SBI will offer the scheme only to top-quality builders, and within exposure limit. It has started with seven centers. Response initially is positive. SBI will treat it as exposure on builder, and legally structured so that SBI has the full power and it will be a bankruptcy remote structure. The bank is currently carrying out 12 projects with a total value of ~Rs 6,000 crore.
- Domestic NIMs are at over 3% and will be stable at this rate. NIM gain coming from quality portfolio is possible, but NII related gains is limited.
- No new mortality table adopted, employee wage increase is 3-4% but mostly accounts for Retiral expenses due to mortality changes.
- **Corporate loans (BB and below):** There is an improvement of 3% in BBB+ loans.
- Bank has 92% of housing loans tied to properties, where people are actually occupying that reflects the quality of this portfolio.
- Farm loan waivers have affected SBI's agri-loan portfolio. Impact of agri loans on divergence stood at Rs. 3,500 crores.
- All divergence has been recognised completely in Q3FY20.
- Recovery from Power, steel and edible oil sector exposures have all have been completed.

Results — Rs cr

Particulars	Q3FY20	Q3FY19	y-o-y (%)	Q2FY20	q-o-q (%)
Interest earned	67,692	62,277	8.7	64,312	5.3
Interest expended	39,913	39,586	0.8	39,712	0.5
Net interest income	**27,779**	**22,691**	**22.4**	**24,600**	**12.9**
Non-interest income	9,106	8,035	13.3	8,538	6.6
Net total Income	36,885	30,726	20.0	33,139	11.3
Operating expenses	18,662	18,101	3.1	18,424	1.3
Pre-provisioning profit	**18,223**	**12,625**	**44.3**	**14,714**	**23.8**
Provisions	7,253	6,006	20.8	13,139	-44.8
Profit before tax	**10,970**	**6,619**	**65.7**	**5,060**	**116.8**
Tax	5,386	2,664	102.2	2,048	163.0
Profit after tax	**5,583**	**3,955**	**41.2**	**3,012**	**85.4**

Source: Company; Sharekhan Research

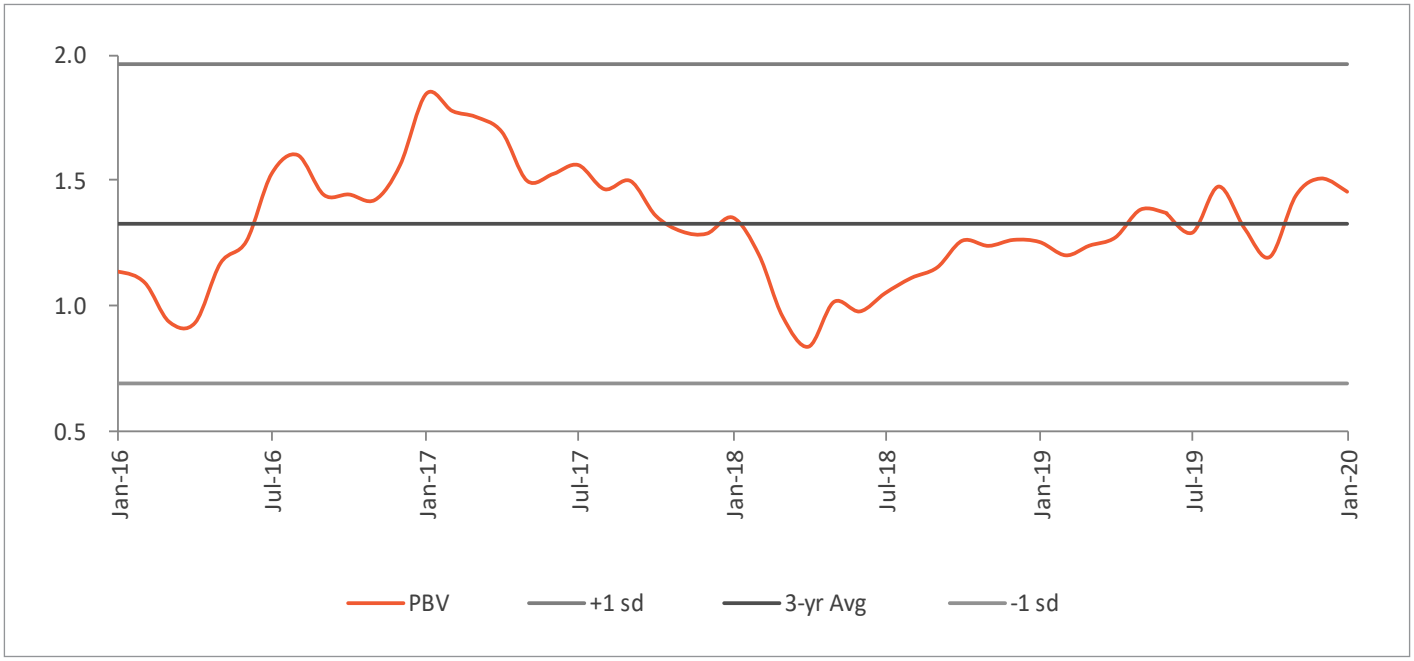
Outlook

SBI's Q3 results indicate that the worst in terms of elevated NPA recognition phase appears to be behind for the bank and going forward, though the credit cycle improvement will be at a slow pace and in a nonlinear manner, the direction will be positive. The management exuded confidence about NIM and asset-quality performance going forward, and a healthy provisioning cover on the balance sheet are comfort factors. SBI has opted for strengthening of the balance sheet and, thus, the trend of improving provision coverage in NCLT accounts and an improving PCR ratio is positive. SBI is well capitalised and, coupled with an enviable reach and business strength, we expect SBI is well placed to gain market share as well as quality clients in the medium to long term. SBI's status as the market maker in terms of domestic interest rates places it at an advantage to other PSU bank peers, providing a cushion to margins. The management stated that they had taken full effect of FY2019 divergences and most of the large stressed exposures are already been taken into account. While growth is likely to take some time to recover, the outlook appears more promising in terms of asset quality performance going forward. Improving balance sheet position, strong capital adequacy (CET-1 at 10.18%) and improved outlook for SBI are key positives.

Valuation

SBI currently trades at 1.1 x its FY2022E book value, which we believe is reasonable considering an improving balance sheet strength and robust capitalisation. We believe that an improving asset-quality outlook, balance sheet strength, strong capitalization and strong operating metrics are key positives for it. We have introduced FY22E estimates and accordingly rollover the price target. We maintain our Buy rating on the stock with a revised PT of Rs. 415.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
State Bank of India	282	1.2	1.1	15.5	9.0	0.3	0.4	5.1	7.3
Punjab National Bank	61	0.5	0.5	3.7	3.1	0.4	0.4	9.7	14.6

Source: Company, Sharekhan research

About company

State Bank of India (SBI) is a largest public sector bank in terms of assets, deposits, branches, number of customers and employees having pan-India presence. The bank has been designated by the RBI as a Domestic Systemically Important Bank (D-SIB), which means that its continued functioning is critical for the economy. The bank is better capitalized than most PSU banks, it is well placed to gain market share as well as key clients by virtue of lesser competitive pressures.. The bank is well placed to secure growth capital from the government, not only by virtue of being the largest bank, but also with operating parameters that have improved greatly as compared to its peers.

Investment theme

State Bank of India enjoys a dominant position and market share in the Indian banking space, which we expect to be maintained in the foreseeable future as well, by virtue of its deep penetration and superior systems. SBI has a strong presence in both retail liabilities as well as retail asset side along with its Corporate relationships (due to size, history and market knowledge) which are key differentiators for it. Also, due to its size, SBI is the market maker for Interest rates which not only puts it in a dominant position but also will allow it with margin cushion. Going forward, as NCLT / IBC etc work to resolve / recover tangled NPAs, with crucial Govt support leading to faster resolutions, and better loan discipline. We expect a gradual normalization NPA recognition from here. SBI has the largest customer base in the country, by virtue of its largest and pan-India network which enables it to be the banker of preference across India but also allows it to explore cross sell opportunities.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/ or retail segments due to the overall macroeconomic slowdown would affect profitability.

Additional Data

Key management personnel

Shri Rajnish Kumar	Chairman
Shri P. K. Gupta	Managing Director (Retail & Digital Banking)
Shri Dinesh Kumar Khara	Managing Director (Global Banking & Subsidiaries)
Shri Arijit Basu	Managing Director (Commercial Clients Group & IT)
Shri Anil Kishora	Deputy Managing Director & Chief Risk Officer
Shri B. Ramesh Babu	Deputy Managing Director & Chief Operating Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.1
2	HDFC Asset Management Co Ltd	3.4
3	SBI Funds Management Pvt Ltd	2.2
4	ICICI Prudential Asset Management	2.05
5	Reliance Capital Trustee Co Ltd	1.8
6	Aditya Birla Sun Life Asset Manage	0.8
7	Kotak Mahindra Asset Management Co	0.8
8	BlackRock Inc	0.7
9	Franklin Resources Inc	0.6
10	FMR LLC	0.6

Source: Bloomberg

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