Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

State Bank of India

Q2 meets hopes, all eyes on asset quality

Banks & Finance	Sharekhan code: SBIN	Result Update

Summary

- State Bank of India's (SBI's) Q2FY2021 numbers largely met expectations, wherein operational numbers were in-line, but asset quality performance was mixed.
- Collection efficiency for domestic loans (excl. agri loans) is at an encouraging 97%. However, on a normalised basis, asset quality deteriorated marginally, with GNPA and NNPA ratios increasing by 44 bps and 22 bps, respectively.
- Asset quality picture appears manageable, PCR of 88.2% is a cushion for investors; legacy assets are well-provided for; margins expected to be stable
- SBI currently trades at 0.8x / 0.7x its FY2022E / FY2023E book value; we maintain a Buy rating on stock with an unchanged SOTP-based PT of Rs 280.

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 207**	
Price Target: **Rs. 280**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

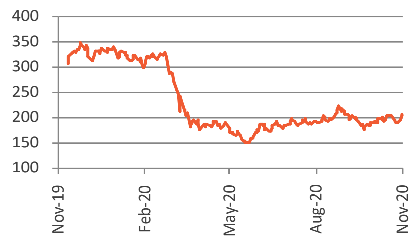
Company details

Market cap:	Rs. 184,787 cr
52-week high/low:	Rs. 351/150
NSE volume: (No of shares)	632.6 lakh
BSE code:	500112
NSE code:	SBIN
Free float: (No of shares)	384.5 cr

Shareholding (%)

Promoters	56.9
FII	9.2
DII	25.0
Others	8.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.7	8.1	15.8	-34.1
Relative to Sensex	5.5	0.3	-12.3	-34.9

Sharekhan Research, Bloomberg

State Bank of India reported largely in-line performance for Q2FY2021, with operational numbers also meeting expectations. However, asset quality performance was mixed. Collection efficiency in domestic loans (excluding agri-loans) as at the end of Q2FY21 stands at 97%. Sanctions and disbursements rose sharply on a y-o-y basis in the quarter for most retail products. Reported asset quality improved q-o-q, but deteriorated slightly on a pro-forma basis. During the quarter, the bank saw reported asset quality improve on sequential basis, with GNPA / NNPA ratios declining by 16 bps and 27 bps respectively, to 5.28% and 1.59%. However, on a proforma basis, GNPA and NNPA ratios rose by 44 bps and 22 bps, respectively. The bank indicated that likely total amount of slippages and restructuring at the end of FY2021 is at Rs. 60,000 crore (around 2.5% of gross advances), which is manageable. Also, the bank stated that only ~Rs 2,000 crore of provisions (~5.8% of H1 FY2021 PPOP) remain to be taken in for the amount, which is expected to be taken in H2. Hence, for now, asset quality picture appears to be manageable. Also, the bank shared that due to restrictions on contacting clients (in the agriculture segment, etc) it saw slippages rise in the category, which is expected to gradually normalise. Provisioning coverage ratio (PCR) reached at 88.2% from 86.32% in Q1 FY2021 and is a cushion for investors. The management's tone was positive in terms of asset quality, with expectations of recovery and resolution in H2FY2021. SBI is likely to benefit from the expected consolidation in the banking sector in terms of customers and liability franchise, which augur well for India's largest bank. Moreover, its healthy PCR indicates less residual stress from the legacy book. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates with this note. We maintain a Buy rating on the stock with an unchanged SOTP based PT of Rs. 280.

Key Positives

- Domestic NIM for stood at 3.34%, rising by 12 bps y-o-y and 10 bps q-o-q, as Cost of funds declined and there were no interest reversals.
- Capital adequacy ratio has increased to 14.72% up 113 bps q-o-q.
- SBI continues to demonstrate a strong liability franchise and savings account balances have increased by 16.28% y-o-y; CASA stands at 45.39%, up 26 bps y-o-y and 5 bps q-o-q.

Key Negatives

- Fresh slippages (on a proforma basis Rs. 14,388 crore) came at Rs 17,144 crores, from Rs 3,637 crore.
- Domestic loan book growth was tepid at 6.02% y-o-y, with only retail segment leading growth at 14.55% y-o-y.

Our Call

Valuation: SBI currently trades at 0.8x / 0.7x its FY2022E / FY2023E book value, which we believe are reasonable. While we are cautious on PSU Banks, we find SBI better placed as compared to its PSU bank peers (with respect to asset quality, capitalisation, underwriting strength etc) with business strengths (being the largest bank in India), with consistent and reasonable margin cushions. Moreover, high coverage and improving business outlook are positive cushions. Its healthy PCR of 88.19% indicates less residual stress from the legacy book. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates with this note. We maintain a BUY rating on the stock with an unchanged SOTP-based price target of Rs 280.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/or retail segments, due to overall macroeconomic slowdown and prolonged pandemic recovery would impact growth and profitability.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	88,349	98,085	1,08,444	1,22,075	1,41,375
Net profit	862	14,488	15,656	21,553	28,563
EPS (Rs)	1.0	16.2	17.5	24.2	32.0
PE (x)	210.6	12.5	11.6	8.4	6.4
Adj book value (Rs/ share)	139.4	178.8	172.6	216.5	268.6
P/ABV (x)	1.5	1.1	1.2	0.9	0.8
RoE (%)	0.4	6.4	6.6	8.5	10.5
RoA (%)	0.0	0.4	0.4	0.5	0.5

Source: Company; Sharekhan estimates

Operational performance strong, but other aspects were mixed bag

Net Interest Income (NII) stood at Rs. 28,181 crore, up 14.6% y-o-y and 5.8% q-o-q, marginally better than expectations while the PAT at Rs 4573 crore, up by 9.2% q-o-q was better than expectations. Non-Interest Income (Excl. one-off Items) remained flat with Q2FY21 at Rs. 8,528 crore as against Rs.8,538 crore in Q2FY20. Domestic Net Interest Margin (NIM) improved to 3.34% in Q2FY21, rising by 12 bps y-o-y.

Total Deposits grew by 14.41% y-o-y, of which current account deposits grew by 8.55% y-o-y, while saving account deposits grew by 16.28% y-o-y. Credit growth stood at a tepid 6.02% y-o-y, mainly driven by retail (Personal) advances (14.55% y-o-y), Agri Advances (4.19% y-o-y) and Corporate Advances (2.82% y-o-y). With the y-o-y growth in corporate bonds / CPs at Rs. 54,980 crore taken together, the loan book has grown by 7.97% y-o-y. The home loan, which constitutes 23% of the bank's domestic advances, has grown by 10.34% y-o-y.

The Cost-to-income ratio has improved from 53.47% in H1FY20 to 52.61% in H1FY21, an improvement of 86 bps. Capital Adequacy Ratio (CAR) has improved by 113 bps y-o-y to 14.72% as on September 2020. Return on Assets (RoA) increased by 14 bps y-o-y to 0.43% in H1FY21 against 0.29% in H1FY20

The Provisions, declined to Rs 10118 crores, down 19% q-o-q and 23% YOY basis. During the quarter, the bank saw reported asset quality improve on sequential basis, with GNPA / NNPAs declining by 16 bps and 27 bps respectively, to 5.28% and 1.59%.

NNPA ratio at 1.59% fell 120 bps y-o-y and 27 bps q-o-q. GNPA ratio at 5.28% is down 191 bps y-o-y and 16 bps q-o-q. Provision coverage ratio (PCR) improved to 88.19%, up 696 bps y-o-y and 187 bps q-o-q. Slippages ratio declined to 0.46% from 1.57% at the end of Q2FY20. Credit cost has declined by 103 bps y-o-y to 0.94%.

However, on a proforma basis, the asset quailty detereriorated marginally, with GNPA and NNPA ratio increasing 44 bps and 22 bps, respectively.

Key Concall Highlights

Current assessment: The management believes that most companies are indicating a pick-up to near pre-Covid levels. The scenario is improving after easing of lockdowns. The pick-up in retail and home loan disbursements is higher than earlier. SBI sees its liablity scenario as comfortable.

Long-term fundamentals: SBI is a dominant player in industry, but has challenges unique to its size. Improving credit underwriting and risk mangagment and will lead to better ROE, ROA in future. Subsidiaries have adequate capital and world-class processes. The previous quarters saw benefits of the SBI Life stake sale and are hence not comparable.

Collection efficiency stood at 97% (by value), excluding agriculture, for Q2 FY2021. October will be slightly better at 97.5%. The remaining 3% are customers who are of the category 7-89 days per due (dpd) accounts. This covers all loans, expect the agriculture segment.

Rise in Agri and MSME NPLs: The SME book saw a significant pullback, and NPAs stood at Rs. 2,400 crore. In the agricultural segment, slippages amounted to Rs. 9700 crore, but saw some pullback, thus the number dropped to Rs. 8,400 crore. Field staff faced restrictions in collections, and with the easing of the lockdown, ability to reach borrowers is coming back and hence pullback. SBI expects agri loan recoveries and renewals to be better in H2.

Pullack on additonal slippages: Total slippages stood at Rs. 20,781 crore for H1FY2021, out of which SBI has been able to pullback half in October.

Collection challenges: Home loans are not much of a problem in terms of recovery as these loans are mostly to salaried borrowers. However, the bank is seeing weaker collections on unsecured loans.

Employee provisions: There was a one-off element to employee cost during Q2 FY2021. SBI had earlier made provison assuming salary rise of 10%, but due to a 15% rise as per the recent wage agreement, it had to raise provisions. Thus, SBI had to provide higher Rs. 1,000 crore + Rs. 600 crore for pension / gratuity, etc. The resultant increase in salary costs will be Rs. 200 crore per month, so Rs. 600 crore higher per quarter. Thus, employee costs should come down by Rs. 1,000 crore from Q3.

Provisions: In Q1FY21, SBI had taken provisions of Rs. 3450 crore for a housing loan company. Corporate PCR stood at 88%, legacy book is already well-provided and is not expecting a surprise. Average run-rate of slippages is Rs. ~10,000 crore per quarter. Hence with provisions of Rs. 7,091 crore, only Rs. 2,000 crore of provisions remain which will be set aside in the next two quarters.

Asset quality outlook: The bank has done a granular assessment of the corproate book and is confident on asset quality. It expects to see interest reversal of ~Rs. 876 crore, if vulnerable loans turn bad, will have to be taken in H2 FY2021.

ECLGS Loans: Disbursements amounted to Rs. 22,000 crore and the bank had sanctioned Rs. 25,000 crore

Potential Restructuring of accounts: Customers who have approched SBI for restructuring stood at Rs 2,500 crore in the retail segment, and Rs. 4,000 crore of loans in the SME segment.

Resolution on a steel company account and a housing finance company account is under process. It is expected that by end of 2020, NCLT process will be resumed. Bank expects recovery of Rs. 6,000-7,000 crore (from NCLT-linked loans, etc) in H2FY2021. This will be over and above the steel and housing finance company accounts.

Corporate loan book: 'A and above' rated borrowers have declined y-o-y, mainly due to financial positions of corporates. Visiblity of demand from corproate, PSUs should remain strong.

Home loan and retail book: Around 94% outstanding to government employees for personal loans; eligibility linked to their salary accounts.

Return Ratios: Bank expects ROE / ROA trajectory to normalise in FY2022.

YONO App: The bank is introducing YONO app in the Agri, Global segments, etc. Going forward, we expect YONO to becoming stronger. The 28.5 million customers of the app are a subset of the bankk's 490 million customers.

Capital Raise: The bank raised Rs. 19,931 crore in Tier-2 and AT1 capital. The board mandated policy is to maintain CET1 and CRAR at 100 bps above regulatory requirements. Around 14% CRAR is what the bank looks to maintain. After renewing some bonds, which are falling due in next few moths, it will be able to maintain its CRAR.

Customers for Express Credit: Express Credit (unsecured loans) is wholly given to salaried employees while 94% is to government staff and armed forces.

Stressed sector exposures: The aviation, airports and tourism & hotels sectors together have a <1% share in overall loans. Hence the bank has minimal exposure to the vulnerable sectors.

Growth avenues: Grwoth in the real economy, retail, PSU undertakings (via capex), road construction and renewable energy sectors may offer the bank growth opportunities. Segments like FMCG, Pharma etc may see capex activity.

SMA loans: SMA 0 + SMA 1 + SMA 2 would be ~3% of loans (excluding agriculture).

Balance transfer: Housing Loans are very competitive. The bank is trying to build a quality business. Migration and takeover is a continous process.

Credit cost: If bank wants to achieve 80-90 bps RoA, then it would look to have a credit cost at <2%.

Provision outlook: Estimated slippages + restructuing of Rs. 60,000 crore and if 15% provision has to be made, it will need to provide Rs. 9,000 crore, out of which Rs. 7,091 crore has already been provided, and remaining will depend on the economic environment.

Results Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y %	Q1FY21	q-o-q %
Interest income	66814.1	64312.0	3.9	66500.0	0.5
Interest expense	38632.6	39712.0	-2.7	39859.0	-3.1
Net interest income	28181.5	24600.0	14.6	26641.0	5.8
Non-interest income	8527.3	8538.4	-0.1	7957.5	7.2
Net total income	36708.8	33138.4	10.8	34598.5	6.1
Operating expenses	20249.4	18424.0	9.9	18078.0	12.0
Pre-provisioning profit	16459.4	14714.4	11.9	16520.5	-0.4
Provisions	10118.3	13138.9	-23.0	12501.3	-19.1
Exceptional Item	0.0	3484.3	-100.0	1539.7	-100.0
Profit before tax	6341.1	5059.8	25.3	5558.9	14.1
Tax	1767.3	2048.1	-13.7	1370.1	29.0
Profit after tax	4573.8	3011.7	51.9	4188.8	9.2

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Headwinds continue for PSU Banks

The economy is showing signs of gradual return to recovery, which augurs well for long-term demand outlook. However, potential risks due to stress in the economy along with uncertainty on COVID-19 related developments continues to pose a challenge, especially for PSU banks. While the recent regulatory measures have cushioned on the earnings front (at least, especially on the asset-quality recognition part) and the gradual return to normalised business traction will be positive for BFSI companies, we believe the capital constrained PSU banks which and still are burdened with legacy NPAs may take longer to recover and hence, near-term return ratios may remain weak.

■ Company outlook - Better placed compared to PSU banking peers

SBI posted encouraging results, but asset quality was arguably helped by the standstill on NPA recognition and thus asset quality would remain a key monitorable. Q2 results indicate that business strength and the last few years' efforts on cleaning up the books have stood the bank in good stead for reducing slippages and supporting margins. Management commentary exuded confidence about NIMs and asset-quality performance going forward; and a healthy provisioning cover on the balance sheet is a comfort factor. The management reiterated that it had taken most of the provisions for the legacy book of large stressed exposures into account and going forward, the impact of residual provisions is likely to be manageable. 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 and its strong growth in mortgages and deposits book is proof to its market strength. SBI's pole position in terms of liability franchise, and an enviable reach and business strength make it well-placed to ride over medium-term challenges.

■ Valuation - Maintain our Hold rating with unchanged PT of Rs. 280

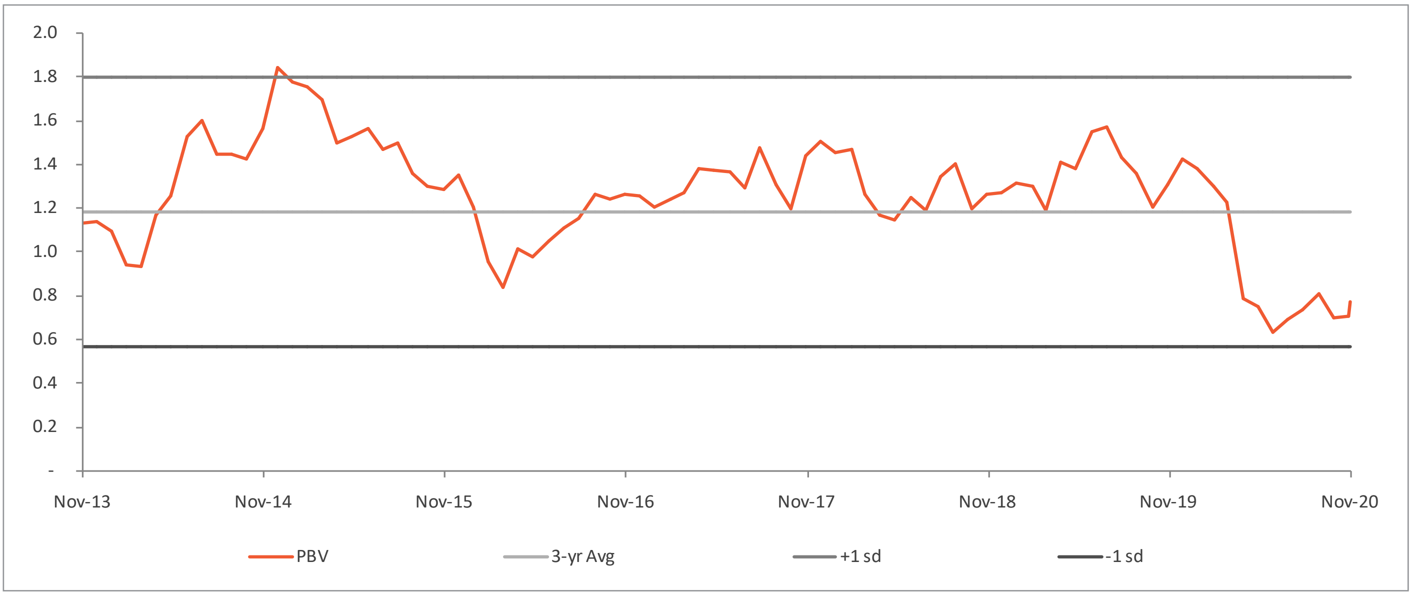
SBI currently trades at 0.8x / 0.7x its FY2022E / FY2023E book value, which we believe are reasonable. While we are cautious on PSU Banks, we find SBI better placed as compared to its PSU bank peers (with respect to asset quality, capitalisation, underwriting strength etc) with business strengths (being the largest bank in India), with consistent and reasonable margin cushions. Moreover, high coverage and improving business outlook are positive cushions. Its healthy PCR of 88.19% indicates less residual stress from the legacy book. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates with this note. We maintain a BUY rating on the stock with an unchanged SOTP-based price target of Rs 280.

SOTP Valuation

SBI Bank SOTP	Holding (%)	Valuation Methodology	Value per share	Contribution to TP (%)
SBI Bank - Parent	100%	0.7x FY2023E ABPVS	177	63%
Subsidiaries				
Life Insurance Subsidiary	55.5%	Market Cap post 25% Holdco Discount	37	13%
Cards Subsidiary	69.5%	Market Cap post 25% Holdco Discount	45	16%
AMC Subsidiary	63.0%	5% of AUM as on Sep 2020; 25% Hold-co discount	11	4%
Others			10	4%
		SOTP based Price Target	280	

Source: Company; Sharekhan Research

One-year forward P/B (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
State Bank of India	207	0.9	0.8	11.8	8.6	0.5	0.6	8.8	10.0
Punjab National Bank	27	1.0	0.6	54.6	9.8	0.1	0.2	0.7	3.2
Union Bank of India	24	0.2	0.3	11.4	6.8	0.1	0.2	2.7	5.3

Source: Company, Sharekhan Research

About company

SBI is the 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 capitalised 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

SBI 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. Moreover, due to its size, SBI is the market maker for interest rates, which not only puts it in a dominant position, but it also allows it with margin cushion. 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 and allows it to explore cross-sell opportunities. The bank's subsidiaries are strong players in their respective fields and provide further valuation support to the parent bank.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/or retail segments, due to overall macroeconomic slowdown and prolonged pandemic recovery would impact growth and profitability.

Additional Data

Key management personnel

Shri Dinesh Kumar Khara	Chairman
Shri Challa Sreenivasulu Setty	Managing Director
Shri Dhananjaya Tambe	Deputy MD/CIO
Shri B Ramesh Babu	Deputy MD/COO
Shri Sanjay Abhyankar	VP:Compliance & Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.85
2	HDFC Asset Management Co Ltd	3.7
3	SBI Funds Management Pvt Ltd	2.23
4	Reliance Capital Trustee Co Ltd	1.59
5	ICICI PRUDENTIAL ASSET MGMT CO	1.25
6	BANK OF NEW YORK MELLON CORP/THE	1.24
7	ICICI Prudential Asset Management	1.23
8	GIC Pte Ltd	1.15
9	Franklin Resources Inc	0.89
10	Kotak Mahindra Asset Management Co	0.72

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan
by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;