Equity Research

November 10, 2011

BSE Sensex: 17362

INDIA

State Bank of India

BUY

Maintained

Slippages woe aggravated, mars core performance **Rs1,862**

Reason for report: Q2FY12 results review

Banking

Target price Rs2,277

Shareholding pattern

	Mar '11	Jun '11	Sep '11
Promoters	59.4	59.4	59.4
Institutional investors	28.7	28.3	27.2
MFs and UTI	4.5	4.5	5.1
Insurance Cos.	12.7	12.9	13.4
FIIs	11.5	10.9	8.7
Others	11.9	11.1	13.4

Source: BSE

Price chart

State Bank of India's (SBI) strong core performance was completely overshadowed by a sharp rise in slippages and marked slowdown in recoveries, leading to a 22% QoQ rise in absolute gross NPAs to Rs339.5bn or 4.19%. Despite higher loan-loss provisions of 150bps, the provision coverage ratio declined by 270bps QoQ to 52.5% on account of sharp rise in gross NPAs. Outstanding restructured loans stood at 4.3% of the total loans and slippages from them in Q2FY12 stood significantly higher at 5%. We raise our gross slippage estimate to 3% for FY12 and 1.8% for FY13, based on the adverse economic environment and the risk of further slippages from restructured accounts. Core performance was strong with NII growth at 28.4% YoY (I-Sec: 22.3%) as NIMs improved 17bps sequentially to a multi-year high of 3.79% in Q2FY12, driven by core spread expansion. We estimate the core spreads to decline towards the end of FY12, on the back of rising cost of funds and estimate the margins (calculated) to decline to 3.1% by FY13. Fee income growth for FY12E will remain muted at 4% YoY on account of the management's conscious business strategy. We build in elevated provisions and expect bottomline growth of 35% for FY12 on a lower base of FY11. Recommend BUY with a SoTP-based target price of Rs2,277/share.

- **Asset quality pressures accelerate, overhang to continue.** Asset quality pressures continued unabated and resulted in a 67bps sequential rise in GNPAs to 4.19%. Slippages were elevated at Rs80bn and the broad-based nature of slippages point to stress in the overall lending portfolio. Recoveries and upgradations during the quarter were lower at Rs17.4bn. The management indicated that some SEB accounts have already proposed restructuring. Going ahead, we expect higher slippages to continue and restructuring to gain momentum. This will keep provisions high and result in earnings CAGR of 34% over FY11-13E despite the low base effect of FY11.
- **Strong margin performance, muted fee income.** Base rate hike of 50bps in Q2FY12 resulted in a 35bps sequential improvement in yield on advances. Unlike peers, cost of deposits for SBI remained firmly under control as the bank shed high-cost bulk deposits and the CASA ratio remained stable at 47.6% for Q2FY12. As a result, NIMs for Q2FY12 were higher at 3.79% *vs* 3.62% in Q1FY12. Core fee income performance in Q2FY12 was flat on a YoY basis even after adjusting for Rs3.5bn one-time fee income in Q2FY11. While core operating performance would remain healthy with NII growth at 28% for FY12E, fee income growth would remain sluggish at 4%.

Market Cap	Rs1,184bn/US$23.7bn
Reuters/Bloomberg	SBI.BO/SBIN IN
Shares Outstanding (mn)	634.9
52-week Range (Rs)	3,273/1,718
Free Float (%)	39.6
FII (%)	8.7
Daily Volume (US$/'000)	124,612
Absolute Return 3m (%)	(18.1)
Absolute Return 12m (%)	(42.1)
Sensex Return 3m (%)	1.4
Sensex Return 12m (%)	(16.8)

Year to March	2010	2011	2012E	2013E
NII (Rs bn)	236.7	325.3	415.4	457.9
Net Profit (Rs bn)	91.7	82.6	111.8	148.1
EPS (Rs)	144.3	130.1	176.0	233.3
% Chg YoY	0.5	-9.8	35.3	32.5
P/E (x)	12.9	14.3	10.6	8.0
P/BV (x)	1.8	1.8	1.6	1.4
Net NPA (%)	1.8	1.7	2.0	1.4
Dividend Yield (%)	1.6	2.1	2.1	2.4
RoA (%)	0.9	0.7	0.9	1.0
RoE (%)	14.8	12.6	16.0	18.6

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Table 1: Q2FY12 results review

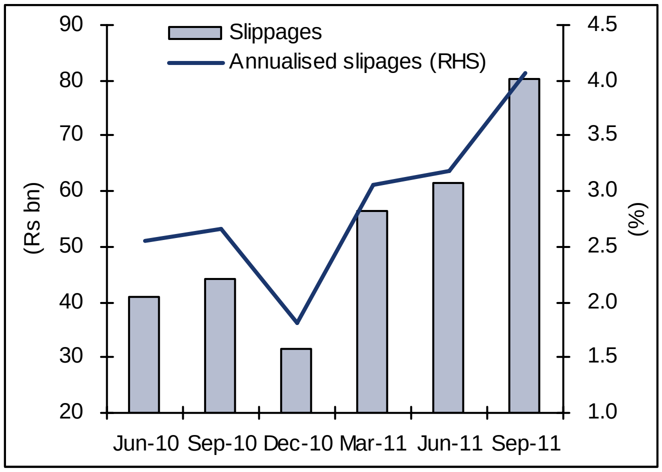
(Rs bn, year ending March 31)

	Q2FY12	Q2FY11	% YoY	Q1FY12	% QoQ	YTDFY12	YTDFY11	% YoY
Interest income	259.7	198.1	31.1	242.0	7.3	501.6	382.6	31.1
Interest expense	155.5	116.9	32.9	145.0	7.2	300.4	228.4	31.5
Net interest income	**104.2**	**81.1**	**28.4**	**97.0**	**7.4**	**201.2**	**154.2**	**30.5**
Non-interest income	34.3	40.1	(14.4)	35.3	(3.0)	69.6	77.0	(9.5)
Total income	138.5	121.2	14.2	132.3	4.6	270.8	231.1	17.2
Staff cost	39.1	36.8	6.5	37.2	5.3	76.3	67.5	13.1
Other op expenses	24.6	20.9	17.9	22.7	8.2	47.3	38.7	22.2
Total op expenses	63.7	57.6	10.6	59.9	6.4	123.6	106.2	16.4
Pre-provisioning profit	**74.7**	**63.6**	**17.6**	**72.4**	**3.2**	**147.2**	**124.9**	**17.8**
Total provisions	33.9	26.2	29.1	41.6	(18.6)	75.4	41.7	80.7
PBT	40.9	37.4	9.4	30.9	32.5	71.7	83.2	(13.8)
Tax	12.8	12.3	3.6	15.0	(14.9)	27.8	29.0	(4.2)
PAT	**28.1**	**25.0**	**12.3**	**15.8**	**77.4**	**43.9**	**54.2**	**(18.9)**
NIMs (%)	3.8	3.4		3.6		3.8	3.4	
CASA (%)	47.6	47.8		47.9		47.6	47.8	
CAR (%)	11.4	13.2		11.6		11.4	13.2	
Tier 1 (%)	7.5	9.6		7.6		7.5	9.6	
GNPAs (Rs bn)	339.5	232.0	46.3	277.7	22.2	339.5	232.0	
NNPAs (Rs bn)	161.2	116.0	39.0	124.4	29.6	161.2	116.0	
GNPAs (%)	4.2	3.4		3.5		4.2	3.4	
NNPAs (%)	2.0	1.7		1.6		2.0	1.7	
Provision coverage (%)	52.5	50.0		55.2		52.5	50.0	

Source: Company data, I-Sec research

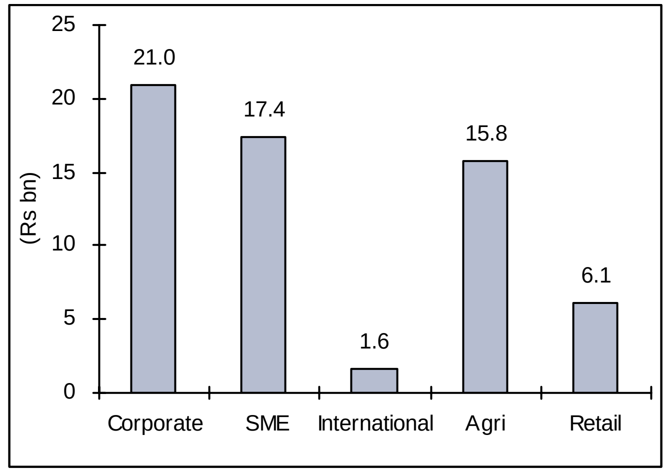
Asset quality overhang continues

Chart 1: Annualised slippages at 4.1% continue to remain at higher than acceptable levels



Source: Company data, I-Sec research

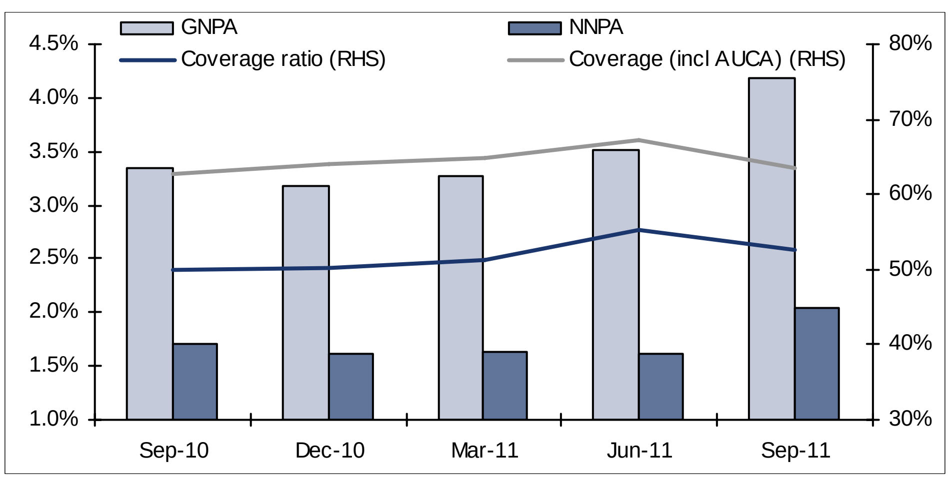
Chart 2: Net increase in GNPAs points to stress in corporate, SME and agriculture portfolios



Source: Company data, I-Sec research

Slippages were extremely high at Rs80bn and broad-based: Agro industry slippages were at Rs12bn, iron & steel at Rs4.77bn, textiles at Rs2.8bn, and paper at Rs1.7bn. Of these, the management is optimistic of recovering/upgrading of Rs20bn from agro-commodity accounts in H2FY12. Recoveries, upgradations and write-offs in Q2FY12 were lower at Rs17.9bn and led to a 22% absolute increase in gross NPAs. Provision coverage declined 270bps QoQ despite loan-loss provisions to the tune of 1.5% or Rs29bn (including Rs5.5bn for complying with RBI's prudential provisioning norms).

Chart 3: GNPAs remain in check; coverage ratio rises



Source: Company data, I-Sec Research

Restructured assets stand at Rs340bn or 4.3% of the total loan book. Of the Rs340bn exposure to the power sector, SEB exposure stands at Rs80bn. The management has indicated that there may not be an immediate respite in slippages and restructuring proposal would rise if the current macro environment continues. Also, we expect recoveries to remain modest at Rs60bn for FY12. As such, we build-in slippages at 3% and 1.8% for FY12E and FY13E respectively.

Loan growth cools-off on expected lines

SBI's domestic loan book growth for Q2FY12 at 15.6% YoY was lower than the overall system growth 20% YoY as lending in the SME and mid-corporate segments slowed down. International credit growth was strong at 18.9% YoY or 13.2% QoQ on higher overseas borrowings by Indian clients. Management indicated that 70% of the bank's international loans are to Indian corporates. Given the lower tier-1 at 7.47% and the tough macor environment, we estimate credit growth to remain at 16.3% for the full year.

Table 2: Domestic growth cools off, international advances healthy

(Rs bn)

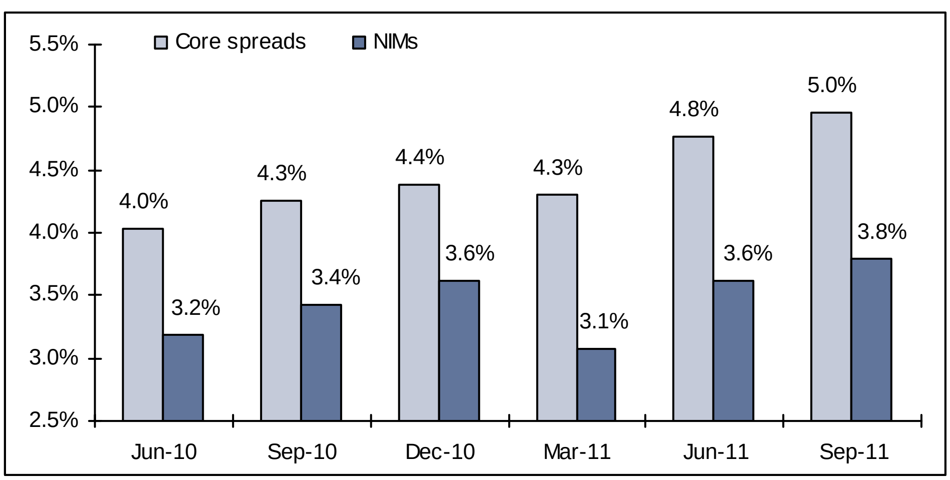
	Q2FY11	Q2FY12	% YoY
Retail advances	1,456	1,702	16.9
Home loans	*793*	*924*	16.5
Auto	*176*	*221*	25.3
Education	*105*	*121*	15.6
Agriculture advances	695	958	37.9
Large corporate	931	1,133	21.8
Mid corporate	1,449	1,613	11.3
SME	1,122	1,260	12.3
International advances	1,055	1,254	18.9
Net advances (domestic)	**6,808**	**7,906**	**16.1**

Source: Company data

Margins at multi-year high, supported by improving spreads

Sustained improvement in core spreads led to SBI's strong operating performance reflected in its 28.4% YoY growth in NII. Core spread improvement was driven by: i) improving yields on the back of the 50bps base rate hike in Q2FY12, and ii) lower than expected cost of deposits on account of strong CASA ratio at 47.6% and shedding of high-cost bulk deposits. As a result, margins expanded 17bps sequentially to 3.79%, the highest-ever in the past few years. Going ahead, we estimate margins (calculated) to cool-off to 3.3% for FY12E as cost of deposits rise and hike in lending rates become increasingly difficult.

Chart 4: Margin improvement driven by expansion in core spreads



Source: Company data, I-Sec research

Fee income weak even after adjusting for one-offs

Even after adjusting for the one-time fee of Rs3.5bn received in Q2FY12, SBI's core fee income performance was flat. We believe this is on account of lower originations and conscious slowing-down of its LC and BG issuances as part of a capital conservation drive. We believe that such an approach would continue and result in a tepid 4% YoY growth in core fee income for FY12.

Table 3: Subdued performance of core fee income; trading gains low

(Rs bn)

	Q2FY11	Q2FY12	% YoY
Commission, ex-brokerage	29.45	26.00	(11.7)
Profit on sale of Investments	1.97	0.28	(85.8)
Forex Income	3.09	4.80	55.5
Dividend	2.9	0.8	(70.8)
Income from leasing	0.00	-	(100.0)
Other Income	2.66	2.34	(12.2)
Total	**40.05**	**34.27**	**(14.4)**

Source: Company data

Valuation methodology and key risks

We follow the sum-of-the-parts methodology to value SBI with price-to-book multiples used to value the bank and its associates, with other businesses valued separately. Sharp asset quality deterioration and large-scale restructuring remain key risks to our call

Table 4: Sum-of-the-parts target price

(Rs)

	Value/share to SBI
SBI (standalone)	1,366
Value of associates	477
Total	**1,843**
SBI Life Insurance Company	352
SBI Mutual Fund	36
Others	46
Value of subsidiaries	**434**
Target price	**2,277**

Source: I-Sec research

Financial Summary

Table 5: Profit and Loss statement

(Rs bn, year ending March 31)

	FY10	FY11	FY12E	FY13E
Interest earned	709.9	813.9	1,067.7	1,247.3
Interest expended	473.2	488.7	652.3	789.4
Net interest income	**236.7**	**325.3**	**415.4**	**457.9**
Other income	149.7	158.2	153.8	160.5
Fee income	96.4	115.6	119.7	130.3
Operating expenses	203.2	230.2	254.1	277.4
Employee costs	144.8	165.1	156.2	169.8
Pre-provisioning profit	**183.2**	**253.3**	**315.0**	**341.0**
Loan and investment loss provisions	43.9	103.8	142.0	119.9
Profit before tax	139.3	149.5	173.0	221.1
Income taxes	47.6	66.9	61.2	73.0
Net profit	**91.7**	**82.6**	**111.8**	**148.1**

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs bn, year ending March 31)

	FY10	FY11	FY12E	FY13E
Share Capital	6.3	6.3	6.4	6.4
Reserves and surplus	653.1	643.5	739.2	844.5
Deposits	8,041.2	9,339.3	10,795.8	12,697.9
Borrowings	1,030.1	1,195.7	1,161.8	1,169.8
Other liabilities and provisions	803.4	1,052.5	1,087.1	2,036.1
Total liabilities & stockholders' equity	**10,534.1**	**12,237.4**	**13,790.2**	**16,754.7**
Cash and balances with RBI	861.9	1,228.7	989.4	1,894.1
Investments	2,957.9	2,956.0	3,465.9	4,019.2
Advances	6,319.1	7,567.2	8,799.4	10,227.7
Fixed Assets, net	44.1	47.6	55.7	59.8
Other Assets	351.1	437.8	479.9	553.9
Total assets	**10,534.1**	**12,237.4**	**13,790.2**	**16,754.7**

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY10	FY11	FY12E	FY13E
Per share data (Rs)				
Period end shares outstanding (mn)	635.0	635.0	635.0	635.0
Basic EPS	144.3	130.1	176.0	233.3
Diluted EPS	144.3	130.1	176.0	233.3
Book value per share	1,038.6	1,023.4	1,174.1	1,339.9
Adjusted book value per share	867.3	829.0	901.6	1,111.3
Growth ratios (%)				
Total assets	9.2	16.2	12.7	21.5
Advances	16.5	19.8	16.3	16.2
Deposits	8.4	16.1	15.6	17.6
Book value	13.8	-1.5	14.7	14.1
EPS	0.5	-9.8	35.3	32.5
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	6.5	4.7	3.8	3.5
P/E	12.9	14.3	10.6	8.0
P/BV	1.8	1.8	1.6	1.4
P/ABV	2.1	2.2	2.1	1.7
Dividend yield (%)	1.6	2.1	2.1	2.4
Operating ratios (%)				
Operating cost to income	52.6	47.6	44.7	44.9
Operating expenses/ Avg. assets	2.1	2.1	2.0	1.9
Profitability ratios (%)				
Spread	3.0	3.7	4.2	4.2
Net interest margin (excluding one-offs)	2.4	3.0	3.3	3.1
Return on avg. assets	0.9	0.7	0.9	1.0
Return on avg net worth	14.8	12.6	16.0	18.6
Asset quality and capital (%)				
Gross NPA	3.1	3.3	4.6	4.6
Net NPA	1.8	1.7	2.0	1.4
Tier 1	8.5	7.7	7.2	6.4

*P/E & P/BV are arrived at after stripping valuations of subsidiaries and associates from price; investments (at cost) in subsidiaries have been stripped from BV for calculating multiples

Source: Company data, I-Sec Research

Table 8: DuPont analysis

(year ending March 31)

	FY10	FY11	FY12E	FY13E
Interest Earned	**7.0**	**7.1**	**8.2**	**8.2**
Interest expended	4.7	4.3	5.0	5.2
NII	**2.3**	**2.9**	**3.2**	**3.0**
- NIM	**2.4**	**3.0**	**3.3**	**3.1**
Other Income	1.5	1.4	1.2	1.1
Total Income Earned	**3.8**	**4.2**	**4.4**	**4.0**
Employee expense	1.4	1.4	1.2	1.1
Operating Expenses & Administrative Expenses	0.6	0.6	0.8	0.7
Total op exp	**2.0**	**2.0**	**2.0**	**1.8**
Pre Provisioning Profit	**1.8**	**2.2**	**2.4**	**2.2**
Provisions & Contingencies	0.4	0.9	1.1	0.8
PBT	**1.4**	**1.3**	**1.3**	**1.4**
Provision for Tax	0.5	0.6	0.5	0.5
PAT	**0.9**	**0.7**	**0.9**	**1.0**

Source: Company data, I-Sec research

New I-Sec investment ratings (all ratings based on absolute return)
BUY: >15% return; ADD: 5% to 15% return; REDUCE: Negative 5% to positive 5% return; SELL: < negative 5% return

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