

2 December 2012

BUY

TP: INR 2,540.00

▲ 17.1%

State Bank of India

SBIN IN

Asset quality improvement likely; upgrade to BUY

We upgrade SBIN to BUY with a TP of Rs 2,540. While the bank reported a weak 2Q, we see asset quality pressures abating at the margin. NIMs could see only limited compression and may pick up with loan growth revival. We also believe SBIN would be the biggest beneficiary in a falling interest rate scenario due to its high mid-corporate/SME exposure. While a likely capital infusion could be a near-term overhang, it would be a long-term positive given the rising capital requirements under Basel III.

- ➔ **Asset quality pressures abating gradually:** While we do not expect a sharp decline in SBIN's slippages, we believe stress is at near-peak levels, especially in the mid-corporate segment (20%+ of the book stressed). Also, SBIN's restructuring has been lower than other PSBs and largely restricted to CDRs. PCR at 63% remains a concern but should improve as core profitability sustains and asset quality improves.
- ➔ **NIMs have likely bottomed out:** While SBIN's LDRs appeared stretched in FY12 at 78.5%, they have corrected by 190bps to 76.6% in H1FY13 – the bank now carries excess balance sheet liquidity of Rs 70bn. We expect LDRs to rise from hereon as loan growth picks up (likely in Q4FY13). This, coupled with re-pricing of residual bulk deposits, would aid NIMs. We note that SBIN's CASA remains solid even in a tough resource mobilisation environment – a reflection of its strong franchise (as against a sharp deterioration for other PSBs).
- ➔ **Pressures persist but likely priced in:** SBIN has of late been efficient in capital utilisation with an estimated 50bps–60bps of tier-I getting released in FY13 (Fig 7). While capital issuance is a near-term overhang, we consider it as a long-term positive given the higher capital requirements under Basel III. Asset quality volatility could continue in the near term, but is likely priced in (current valuations at a 20% discount to the 5-yr average). The stock trades at a premium to other PSBs, which should sustain given SBIN's strong liability franchise and pricing power.

Financial Highlights

Y/E 31 Mar	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income (INR mln)	325,264	432,911	455,885	527,696	615,838
Net revenues (INR mln)	483,510	576,425	632,512	720,222	838,096
Pre-provision profits (INR mln)	253,356	315,735	344,056	390,615	456,862
Adj. PAT (INR mln)	82,645	117,073	141,045	165,906	192,336
Adj. EPS (INR)	130.2	174.5	210.2	247.2	286.6
ROE (%)	12.6	15.7	15.8	16.4	16.7
ROA (%)	0.7	0.9	1.0	1.0	1.0
Gross NPA (%)	3.3	4.4	5.4	4.9	4.9
Tier I ratio (%)	7.8	9.8	9.2	8.9	8.6
P/BV (x)	2.7	1.7	1.5	1.3	1.1
P/E (x)	21.2	12.0	9.8	8.3	7.2

Source: Company, Bloomberg, RCML Research



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PRICE CLOSE (30 Nov 12)

INR 2,170.00

MARKET CAP

INR 1,456,167 mln

USD 26,476 mln

SHARES O/S

671.0 mln

FREE FLOAT

38.4%

3M AVG DAILY VOLUME./VALUE

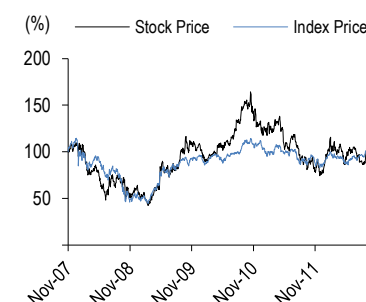
2.9 mln/ USD 112.0 mln

52 WK HIGH

INR 2,452.45

52 WK LOW

INR 1,578.50





Asset quality pressures abating gradually

SBIN's slippages have remained high in the last few quarters as slowdown in economic growth and adverse regulatory actions in some industries have impacted asset quality, particularly in the mid-corporate and SME segments. GNPLs in the mid-corporate, SME and Agri segments have increased to 10%, 10% and 8% respectively. Restructuring in the mid-corporate segment is also high at ~14% of the total book.

While we do not expect slippages to decline significantly in the near term as economic slowdown would still hurt the mid-corporate and SME segments, we believe asset quality pressures would decline at the margin. Reduction in interest rates and improvement in policy actions coupled with a revival in the economy could significantly reduce asset quality pressures in the mid-corporate and SME segments. Our recent interaction with one of the leading credit rating agency also indicates that outlook for the textile segment is improving gradually (~4% of SBIN's exposure in March '12).

Fig 1 - GNPLs has increased significantly

	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Gross NPA (Rs bn)	278	339	401	397	472	492
Gross NPA (%)	3.5	4.2	4.6	4.4	5.0	5.2
Net NPA (Rs bn)	124	161	188	158	203	226
Net NPA (%)	1.6	2.0	2.2	1.8	2.2	2.4
Provision coverage ratio (%)	55.2	52.5	53.1	60.1	56.9	54.0
Provision coverage ratio incl. write-off(%)	67.3	63.5	62.5	68.1	64.3	62.8

Source: RCML Research, Company

Fig 2 - Movement in NPAs

(Rs bn)	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Opening Gross NPA	253.3	277.7	339.5	401.0	396.8	471.6
Add: Slippages	61.8	80.2	81.6	43.8	108.4	85.0
Less: - Up-gradation & Recovery	30.8	17.7	19.7	47.2	32.8	44.8
- Write-offs	6.6	0.7	0.4	0.8	0.8	19.7
Closing Gross NPAs	277.7	339.5	401.0	396.8	471.6	492.0
Annualised slippages (%)	3.7	4.6	4.4	2.3	5.5	4.2

Source: RCML Research, Company

Fig 3 - Sector-wise % of GNPA's

Sector (%)	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13
Large Corporate	0.32	0.31	4.25	1.10	0.41	0.20	0.18
Mid Corporate	3.51	4.13	NA	5.54	7.21	9.28	10.03
International	2.06	2.06	1.95	2.20	1.86	2.00	1.93
SME	3.66	4.19	4.99	7.90	6.36	7.22	9.95
Agri	6.37	7.17	8.92	9.45	9.00	9.80	8.10
Retail	2.65	2.58	2.89	2.84	2.31	2.60	2.63
Total	3.28	3.52	4.19	4.61	4.44	4.99	5.15

Source: Company, RCML Research



Fig 4 - Sector-wise distribution of GNPA's

in Rs bn	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13
Large Corporate	3.53	3.53	122.64	13.6	5.15	2.85	2.66
Mid Corporate	60.05	71.59	NA	116.89	127.47	165.79	170.98
Retail	43.58	42.6	48.7	49.8	41.87	48.21	50.48
Agriculture	45.24	52.55	68.32	76.1	77.78	87.67	93.20
SME	78.33	84.57	75.39	115.13	119.29	134.24	143.89
International	22.53	22.84	24.41	29.46	25.20	32.80	30.81
Total	253.26	277.68	339.46	400.98	396.76	471.56	492.02

Source: Company, RCML Research

Fig 5 - Industry-wise distribution of NPAs in the corporate and SME segment

(Rs bn)	Fresh slippages in				Q1FY13	Q2FY13	NPA as of Sep-12
	Q1FY12	Q2FY12	Q3FY12	Q4FY12			
Iron and Steel+ Metals+Mining	4.1	4.8	8.3	4.8	4.4	5.9	37.3
Govt Sponsored	1.1	2.7	1.1	0.9	1.3	0.9	10.2
Aviation	-	-	11.8	-	-	-	13.1
Infrastructure	6.5	0.6	1.2	5.5	7.9	0.8	7.6
Textiles	4.1	2.9	4.6	8.1	4.8	7.8	34.2
Agro Based	1.5	12.7	2.3	1.1	2.7	3.5	19.7
Paper/ Plastics etc	0.8	1.7	3.2	0.7	1.6	1.2	10.2
Gems & Jewellery	1.2	2.2	0.6	-	0.4	1.1	10.3
Engineering	0.9	0.9	1.2	1.1	6.4	5.6	19.0
Others	16.7	18.5	25.7	12.6	37.3	38.7	156.0
Grand Total	36.8	47.1	60.0	34.9	66.8	65.4	317.5

Source: RCML Research, Company

SBIN's capital utilisation has been efficient of late

We note that SBIN, of late, has been efficient in capital utilisation. Better balance sheet management led to a reduction of Rs 590bn in the total RWA in FY12. As per our estimates, this would have shored up tier 1 by 50bps–60bps. RWA remained flat YoY in FY12 due to better B/S management and muted growth in off B/S liabilities.

Fig 6 - Trends in SBIN's capitalisation ratios

(Rs mn)	FY09	FY10	FY11	FY12
Risk Weighted Assets (RWA)	7,719,177	8,599,035	10,931,660	10,971,404
Total Assets	9,644,321	10,534,137	12,237,362	13,355,192
Advances	5,425,032	6,319,142	7,567,194	8,675,789
Capitalisation ratios (%)				
-Tier 1 Capital	9.4	9.5	7.8	9.8
-Tier 2 Capital	4.9	3.9	4.2	4.1
-Total Capital	14.3	13.4	12	13.9
Growth ratios (%)				
-Growth in Risk Weighted Assets	8	11	27	0
-Growth in Total Assets	34	9	16	9
-Growth in Advances	30	16	20	15
Other ratios (%)				
-RWA / Total Assets	80	81.6	89.3	82.2
-RWA / Advances	142.3	136.1	144.5	126.5

Source: Company, RCML Research



Fig 7 - Break up of release in risk-weighted assets in FY12

Reason	Rs bn
-Led by open limits in undrawn accounts	220
-Led by guarantees re-classification	140
-Led by insurance of export portfolio with ECGC	90
-Led by home loans	90
-Led by SMEs	20
-Miscellaneous	30
Total	590

Source: Company, RCML Research

Likely capital infusion: near-term overhang, long-term positive

SBIN is likely to raise further capital to boost its capital ratios. At the end of Mar '12, the bank's tier I ratio stood at 9.8% and core tier I ratio (after adjusting IPDI) at 9.2%. We note that the minimum tier I ratio (including capital conservation buffer of 2.5%) will increase to 9.5% by Mar'18 in adherence to Basel III norms. Of this, ~1.5% of RWAs could be on account of innovative perpetual debt and preference shares.

We believe PSBs would need to raise capital to meet the higher tier I requirement. Our calculations indicate that SBIN may need fresh capital of ~Rs 315bn if risk weighted assets grow by 15% CAGR (assuming PAT growth of 15% CAGR and payout ratio of 20%). Capital requirement would increase to Rs 500bn if growth increases to 18%. While this would lead to lower ROEs (100bps-150bps compression appears likely), we believe lower leverage would also provide more comfort. Sustainable ROEs would remain at 15%+ even at a higher core tier I ratio of 9%. ROE compression could be even lower if the amount of IPDI and PNCPs are higher or capital costs are lower.

Pressures persist but likely priced in; premium to other PSBs to sustain

While near term headwinds will persist with volatility in slippages, we believe that this is likely priced in. Moreover, SBIN's high CASA levels endure amid a tough deposits market where most PSUs have faced significant pressure over the last few years – a reflection of its very strong franchise and justification of its premium over other PSBs (although asset quality pressures persists across PSBs). Current valuations are at a 20% discount to the 5-year average (a 5% discount to the 5-year average). Our SOTP-based valuation stands at Rs 2,387 in FY13 and Rs 2,700 in FY14. BUY.

Fig 8 - CASA ratio trends for PSU banks

	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13
SBI	46.67	47.51	47.79	48.17	48.66	47.89	47.62	47.52	46.64	46.14	44.95
PNB	40.85	41.60	41.30	39.05	39.20	38.10	37.10	36.20	36.20	35.60	37.00
BoB	35.63	35.23	35.89	35.12	34.36	33.92	34.02	34.05	33.18	32.23	31.75
Bol	32.37	32.34	33.23	32.27	29.18	30.20	31.35	32.16	33.04	31.17	31.82
Canara Bank	29.09	29.03	28.89	29.03	28.27	25.36	25.84	23.91	24.34	23.28	24.81
Dena Bank	35.96	35.69	39.10	35.39	35.42	35.17	35.60	34.90	34.46	30.91	31.86
UBI	31.80	32.57	32.69	33.27	31.76	31.51	32.09	32.54	31.28	30.95	30.50
OBC	24.97	24.91	25.38	25.20	24.56	22.43	22.86	22.28	24.13	24.02	24.13

Source: Company, RCML Research



Fig 9 - SOTP Valuation - FY13E

Businesses	Valuation method	AUM/PAT/BV (Rs mn)	Multiple (x)	Valuation of business (Rs mn)	% stake of SBI	Per share Value
Standalone	P/BV	876,684	1.3	1,139,689	100	1,795
Banking associates						351
SBBJ	P/BV	47,387	1.0	45,017	75	53
SBT	P/BV	43,766	1.0	41,578	75	49
SBH	P/BV	76,746	1.0	72,908	100	115
State Bank of Mysore	P/BV	36,901	1.0	35,056	92	51
State Bank of Patiala	P/BV	55,328	1.0	52,562	100	83
Other businesses						
Life Insurance	Appraisal value					206
SBI MF	% of AUM	494,987	3.5	17,325	63	17
Others						60
Value of other businesses (with 15% discount)						241
Total						2,387

Source: RCML Research, Company

Fig 10 - SOTP valuation - FY14E

Businesses	Valuation method	AUM/PAT/BV (Rs mn)	Multiple (x)	Valuation of business (Rs mn)	% stake of SBI	Per share Value
Standalone	P/BV	1,002,932	1.3	1,303,811	100	2,053
Banking associates						404
SBBJ	P/BV	53,698	1.0	51,013	75	60
SBT	P/BV	50,147	1.0	47,640	75	56
SBH	P/BV	90,868	1.0	86,325	100	136
State Bank of Mysore	P/BV	39,855	1.0	37,862	92	55
State Bank of Patiala	P/BV	64,200	1.0	60,990	100	96
Other businesses						
Life Insurance	Appraisal value					206
SBI MF	% of AUM	544,486	3.5	19,057	63	19
Others						60
Value of other businesses (with 15% discount)						242
Total						2,699

Source: RCML Research, Company



Per Share Data

Y/E 31 Mar (INR)	FY11A	FY12A	FY13E	FY14E	FY15E
Reported EPS	130.2	174.5	210.2	247.2	286.6
Adjusted EPS	130.2	174.5	210.2	247.2	286.6
DPS	29.1	33.8	40.6	48.8	56.5
Book value	1,023.4	1,251.1	1,413.9	1,604.3	1,825.0
Adjusted book value	915.9	1,101.7	1,152.8	1,360.5	1,527.3

Valuation Ratios

Y/E 31 Mar (x)	FY11A	FY12A	FY13E	FY14E	FY15E
P/E	21.2	12.0	9.8	8.3	7.2
P/BV	2.7	1.7	1.5	1.3	1.1
P/ABV	3.0	1.9	1.8	1.5	1.3

Financial Ratios

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
Spread Analysis					
Yield on advances	8.6	10.0	9.9	9.8	9.8
Yield on investments	6.8	7.9	7.5	7.7	7.7
Cost of funds	5.0	5.7	5.9	5.9	6.0
NIMs	3.0	3.5	3.3	3.3	3.3
Operating Ratios					
Operating cost to income	47.6	45.2	45.6	45.8	45.5
Operating expenses / Avg assets	2.0	2.0	2.0	2.0	1.9
Proportion of CASA deposits	49.4	44.8	44.0	43.0	43.0
Non-int inc / Total income	32.7	24.9	27.9	26.7	26.5
Credit / Deposit ratio	81.0	83.1	83.2	82.3	82.4
Investment / Deposit	31.7	29.9	30.0	31.3	30.6
Asset Quality and Capital					
Gross NPA	3.3	4.4	5.4	4.9	4.9
Net NPA	1.6	1.8	2.6	2.1	2.2
Coverage ratio	51.2	60.1	53.4	58.9	57.8
CAR	12.0	13.9	13.1	12.6	12.1
Tier I ratio	7.8	9.8	9.2	8.9	8.6
Growth Ratios					
Net interest income	37.4	33.1	5.3	15.8	16.7
Non-interest income	5.7	(9.3)	23.1	9.0	15.4
Non-interest income (ex-treasury)	16.0	2.5	9.8	14.3	14.7
Pre-provisioning profit	38.3	24.6	9.0	13.5	17.0
Net profit	(9.8)	41.7	20.5	17.6	15.9
Assets	16.2	9.1	16.2	17.0	16.2
Advances	19.8	14.7	17.7	16.7	17.6
Deposits	16.1	11.7	17.5	18.0	17.5
Book value	(1.5)	22.2	13.0	13.5	13.8
EPS	(9.9)	34.0	20.5	17.6	15.9

DuPont Analysis

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income / Assets	2.9	3.4	3.2	3.1	3.1
Non-interest income / Assets	1.4	1.1	1.2	1.1	1.1
Operating expenses / Assets	2.0	2.0	2.0	2.0	1.9
Provisions / Assets	0.9	1.0	0.9	0.8	0.8
Taxes / Assets	0.6	0.5	0.5	0.5	0.5
ROA	0.7	0.9	1.0	1.0	1.0
Equity / Assets	5.7	5.8	6.2	6.0	5.9
ROAE	12.6	15.7	15.8	16.4	16.7



Profit and Loss Statement

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Interest income	813,944	1,065,215	1,202,915	1,413,168	1,662,352
Interest expense	(488,680)	(632,304)	(747,030)	(885,472)	(1,046,514)
Net interest income	325,264	432,911	455,885	527,696	615,838
Non-interest income	158,246	143,514	176,628	192,526	222,257
Non-interest income (ex-treasury)	149,036	152,712	167,628	191,526	219,757
Net revenue	483,510	576,425	632,512	720,222	838,096
Operating expenses	(230,154)	(260,690)	(288,456)	(329,607)	(381,234)
Pre-provision profits	253,356	315,735	344,056	390,615	456,862
Provisions & contingencies	(103,813)	(130,902)	(130,351)	(137,323)	(163,219)
PBT	149,542	184,833	213,705	253,292	293,643
Extraordinaries	0	0	0	0	0
Income tax	(66,897)	(67,760)	(72,660)	(87,386)	(101,307)
Reported PAT	82,645	117,073	141,045	165,906	192,336
Adj. net profit	82,645	117,073	141,045	165,906	192,336

Balance Sheet

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Cash in hand & bal with RBI	943,955	540,759	567,797	596,187	655,806
Bal with banks, money at call	284,786	430,872	452,416	475,037	522,540
Investments	2,956,006	3,121,976	3,679,046	4,528,341	5,196,932
Advances	7,567,194	8,675,789	10,207,129	11,910,363	14,011,348
Fixed assets (net)	47,642	54,665	60,132	66,145	72,760
Other assets	437,778	531,130	557,687	585,571	644,128
Total Assets	12,237,362	13,355,192	15,524,207	18,161,645	21,103,513
Equity capital	6,350	6,710	6,710	6,710	6,710
Reserves & surplus	643,510	832,802	942,112	1,069,859	1,217,958
Net worth (ex-pref capital)	649,860	839,512	948,822	1,076,570	1,224,668
Preference capital	0	0	0	0	0
Deposits	9,339,328	10,436,474	12,262,857	14,470,171	17,002,451
- CASA deposits	4,615,214	4,676,066	5,395,657	6,222,173	7,311,054
- Term deposits	4,724,114	5,760,407	6,867,200	8,247,997	9,691,397
Borrowings (+sub-ord bonds)	1,195,690	1,270,056	1,422,462	1,635,832	1,799,415
Other liabilities & provisions	1,052,484	809,151	890,066	979,073	1,076,980
Total Equity & Liabilities	12,237,362	13,355,192	15,524,207	18,161,645	21,103,513

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