Sharekhan by BNP PARIBAS

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Stock Update

State Bank of India

Strong franchise, reasonable valuations

Banks & Finance	Sharekhan code: SBIN	Company Update

3R MATRIX

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 263**	
Price Target: **Rs. 320**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

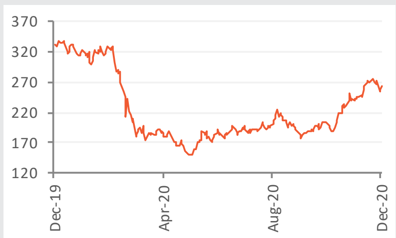
Company details

Market cap:	Rs. 234,717 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	10.2	43.1	36.7	-20.6
Relative to Sensex	4.8	19.8	5.6	-32.6

Sharekhan Research, Bloomberg

Summary

- State Bank of India (SBI) is an attractive play on a gradual recovery in Indian economy, with a healthy PCR (88% including Technical Write Off), robust Tier 1 capital ratio of ~11.9% and a strong liability franchise.
- Manageable asset quality outlook with a 97% collection efficiency, guidance of just Rs. 60,000 crore for FY2021 slippages and restructuring (~2.5% of gross advances), and only ~Rs 2,000 crore of provisions remaining provide comfort.
- Stock trades at 1.2x / 1.0x its FY2022E / FY2023E ABVPS which is reasonable; while we maintain cautious stance on PSU banks, we find that SBI is best-placed with strong fundamentals.
- We maintain a Buy rating on the stock with a revised SOTP-based PT of Rs. 320.

State Bank of India (SBI) is an attractive play on the gradual recovery in the Indian economy, with a healthy PCR of 71% (88% including Technical Write Off or TWO), robust Tier-1 capital ratio of ~11.9%, a strong liability franchise and improved core operating profitability. SBI is India's largest bank with attractive fundamentals and a resilient business model. Collection efficiency in domestic loans (excluding agri-loans) stood at 97% at the end of Q2FY21, which provides comfort. Sanctions and disbursements soared y-o-y basis in Q2FY21 for most retail products. Asset quality outlook appears better, with the bank guiding for total slippages and restructuring of just Rs. 60,000 crore or FY2021 (`2.5% of gross advances), which is manageable. Also, since SBI has only ~Rs 2,000 crore of provisions (~5.8% of H1 FY2021 PPOP) remaining to be taken in (likely to be taken in H2), the asset quality picture appears manageable for now. Moreover, the bank shared that due to restrictions on contacting clients (in agri loans, etc) it saw slippages rise, which is expected to gradually normalise. The management's commentary has been 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 the bank. We are cautious on PSU banks but find SBI as the sole bright spot in the space with best-in-class fundamentals and book quality. Moreover, SBI's healthy PCR and near normal collection efficiency indicates less residual stress from the legacy book. We have fine-tuned our estimates and the target multiples considering the dynamic outlook. We maintain a Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 320.

Our Call

Valuation: SBI currently trades at 1.2x / 1.0x its FY2022E / FY2023E ABVPS, which we believe are reasonable. While we are cautious on PSU Banks, but 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 and the target multiples considering the dynamic outlook. We maintain a Buy rating on the stock with a revised SOTP-based PT of Rs. 320.

Key risk

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

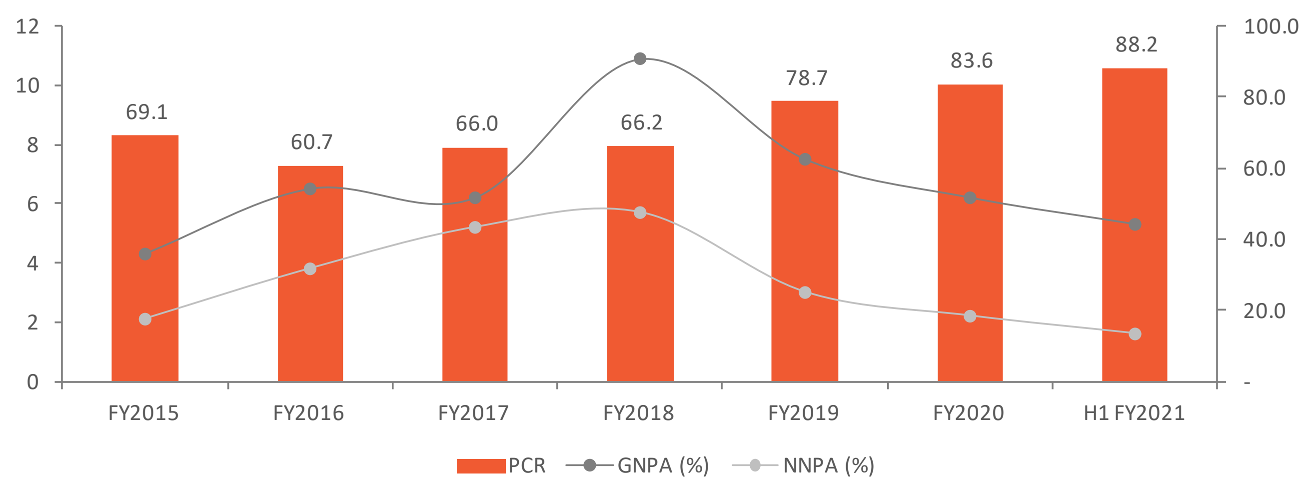
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	88,349	98,085	1,09,022	1,27,507	1,47,102
Net profit	862	14,488	23,573	32,909	40,208
EPS (Rs)	1.0	16.2	26.4	36.9	45.1
PE (x)	272.2	16.2	10.0	7.1	5.8
Adj book value (Rs/share)	139.4	178.8	169.7	215.1	269.5
P/ABV (x)	1.9	1.5	1.5	1.2	1.0
RoE (%)	0.4	6.4	9.8	12.4	13.6
RoA (%)	0.0	0.4	0.6	0.7	0.8

Source: Company; Sharekhan estimates

Comfortably placed on asset quality, backed by rising PCRs

We believe SBI's intrinsic risk profile has improved since Q1, and there has been a gradual improvement in asset quality and profitability. PCR (without AUCA) at 71% and PCR (with AUCA) was the highest-ever in the past six years which indicates less pressure from the legacy assets, which is a comfort factor. Interim improvement in asset quality has also benefited profitability as loan impairment charges declined by an additional 60 bps to 1.3% of loans in 1HFY21 from FY20.

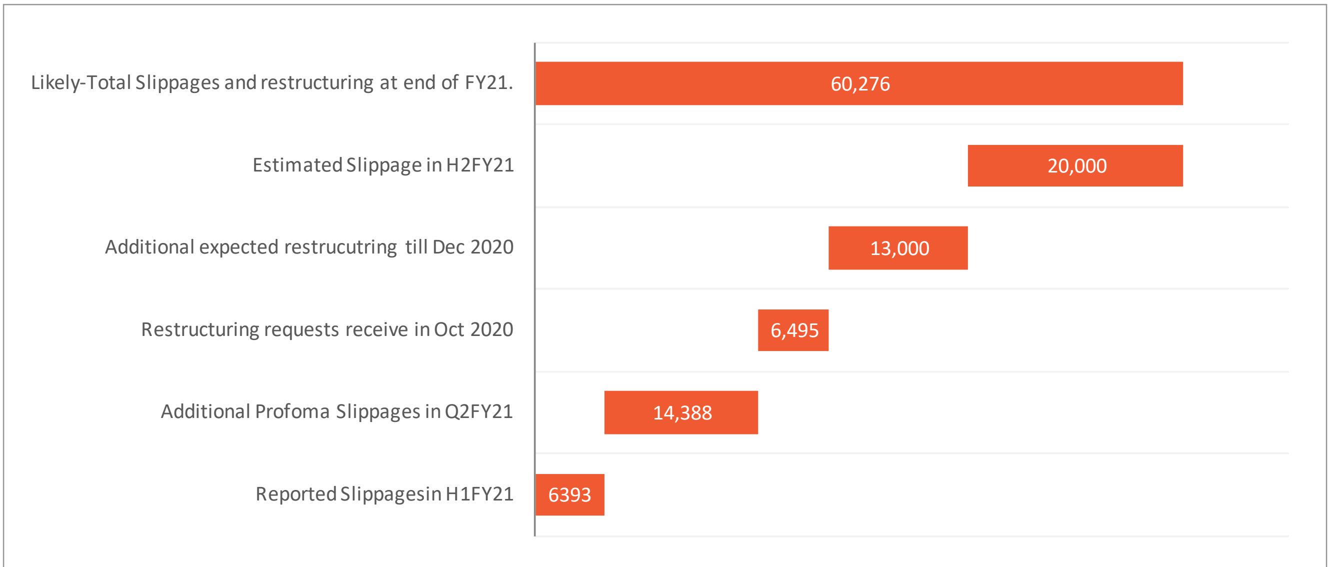
Asset quality issues peaking; high PCR provides support



Source: Company, Sharekhan Research

The management expects ~2.5% of loans to slip into impaired loans category (including restructuring) by end-FY21. Slippages were low in H1FY21 while write-offs remained high, driving a further decline in the bank's gross impaired loans to 5.3% from 6.2% at FY20.

Assessment of Slippages and Restructuring



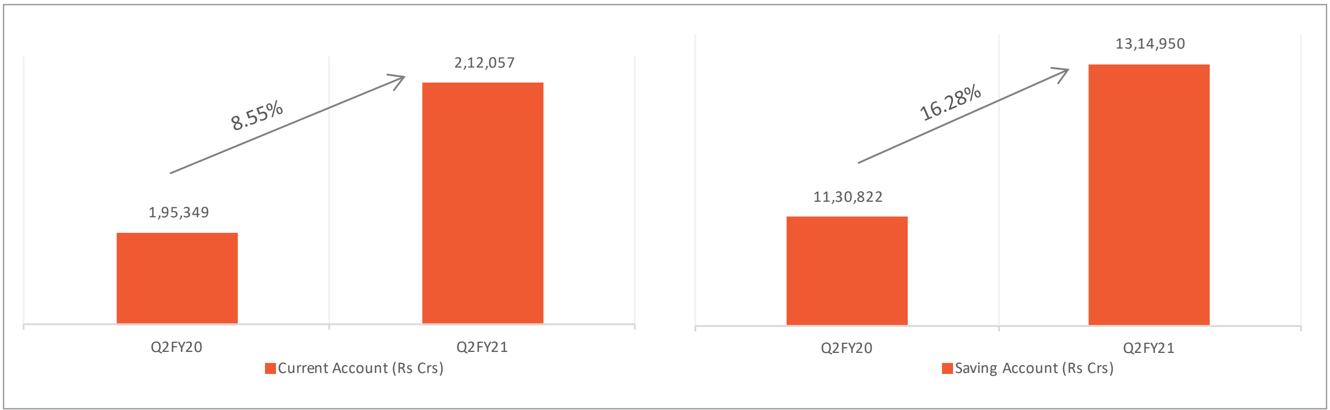
Source: SBI

In the current credit cycle, the SBI expects to outperform PSU bank peers in terms of asset quality. Over the years, it has focused on incremental corporate credit mainly to highly-rated corporates only, which will stand in good stead especially on face of exigencies like the pandemic. A large proportion of the retail loan book comprises customers employed in government/ quasi–government agencies/ large corporates who we believe are relatively unaffected by job loss /salary cut issues seen in the private salaried segment etc. The SME sector is supported by government-guaranteed lending scheme; liberalized financing and handholding and therefore has lesser vulnerabilities.

Dominant banking franchise in India, with best-in-class retail strength

SBI's dominant franchise also ensures continuity of robust funding and liquidity irrespective of rate and asset quality cycles. The bank's common equity Tier 1 (CET1) ratio has improved by 31 bps to 10.5% by Q2 FY2021 end from Q2 FY2020, helped by increased earnings, stake sale benefits (in SBI Life Insurance) as well as incremental lending to less risky sectors and better-rated borrowers. SBI has a buffer of 250 bps over and above the regulatory minimum ratio of 8% (applicable for banks from April 2021) which is comparatively the best among PSU banks, and we believe reasonably adequate. The bank had further augmented its balance sheet, with capital raised (via hybrid capital instruments of Rs 4000 crores) in H1 FY21 which also provides investor comfort.

CASA

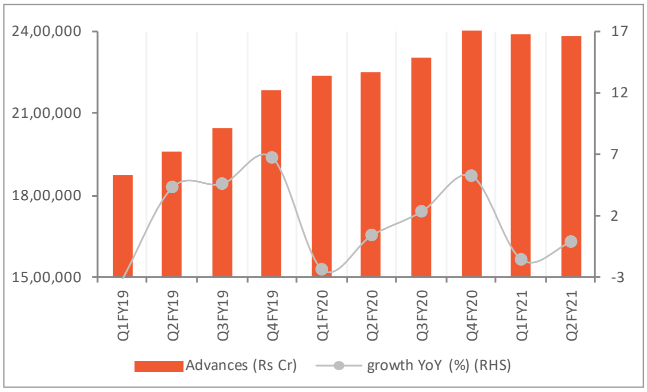


Source: Company, Sharekhan Research

SBI's superior pan-India franchise and funding profile is a positive. Its low-cost deposit ratio was stable at around 45% with customer deposits accounting for 92% of total funding, underpinned by high depositor confidence and a strong brand image (read fail-safe, due to SBI's close identity with the sovereign).

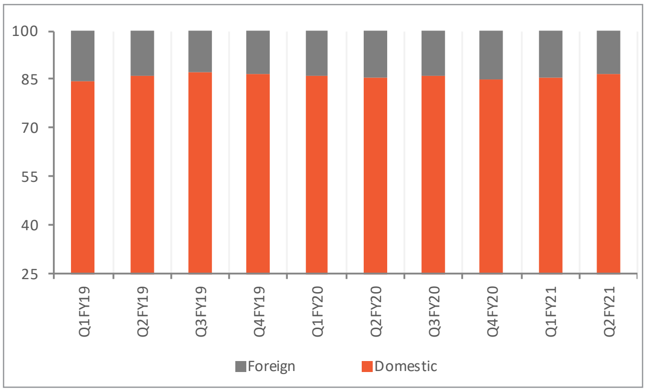
Financials in charts

Advances trend



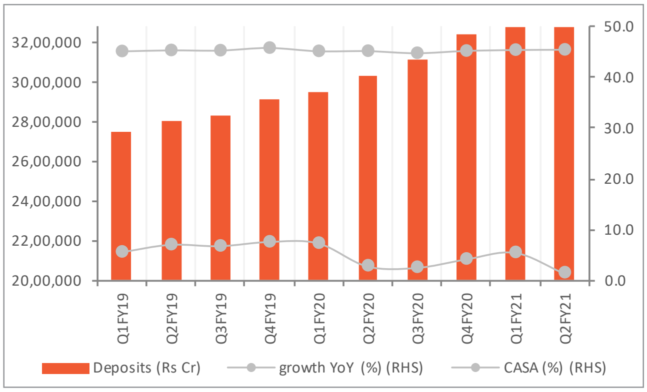
Source: Company, Sharekhan Research

Loan Mix



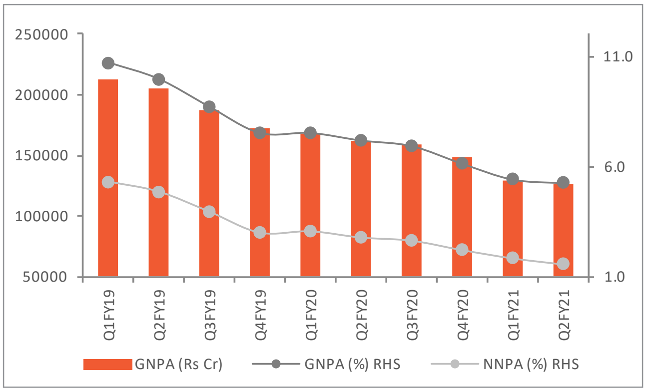
Source: Company, Sharekhan Research

Deposits trend



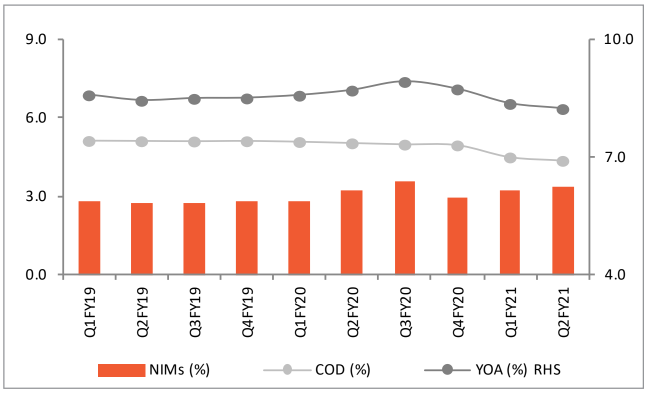
Source: Company, Sharekhan Research

Asset Quality Movement



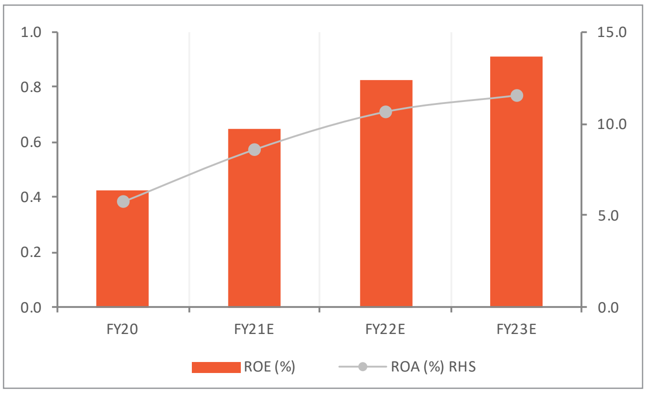
Source: Company, Sharekhan Research

NIMs, Yields on Advances, Cost of Deposits



Source: Company, Sharekhan Research

Return Ratios (Calc.)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Headwinds continue for PSU Banks

The economy is showing signs of a gradual 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

State Bank of India (SBI) is an attractive play on gradual recovery in the Indian economy, with a healthy PCR of 71% (88% including Technical Write Off), robust capitalization (Tier 1 of ~11.9%), a strong liability franchise, and improved core operating profitability. The 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 Buy rating with revised PT of Rs. 320

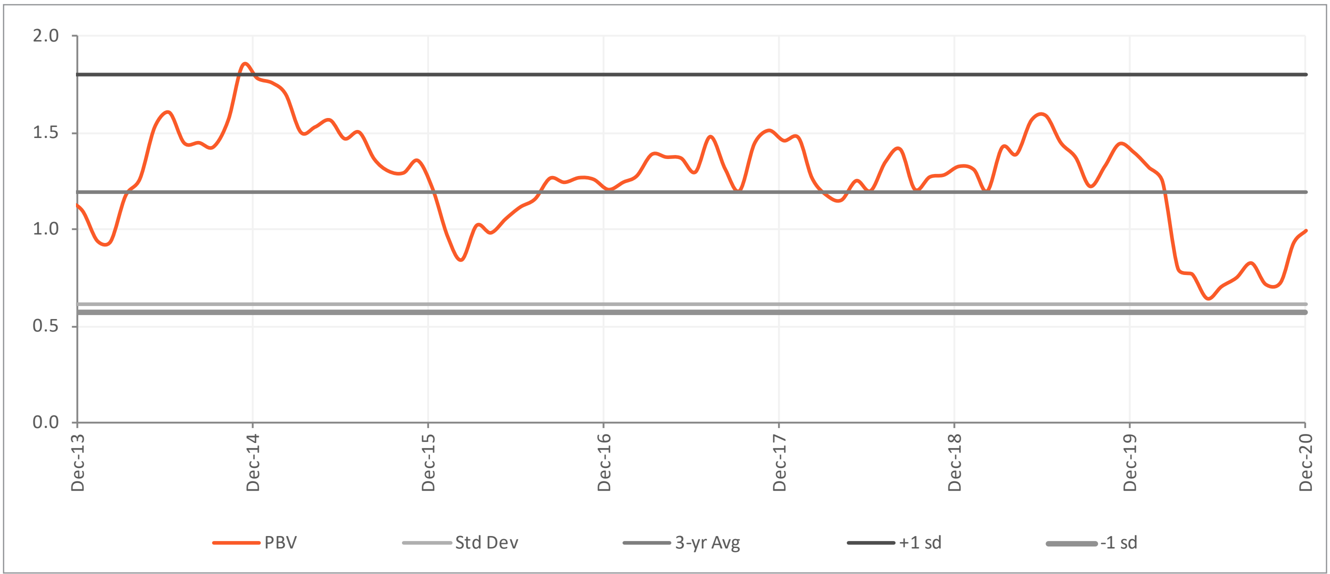
SBI currently trades at 1.2x / 1.0x its FY2022E / FY2023E ABVPS, which we believe are reasonable. While we are cautious on PSU Banks, but we find SBI better placed as compared to its PSU bank peers (with respect to asset quality, capitalisation, underwriting strength, etc) with business strengths (being 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 and the target multiples considering the dynamic outlook. We maintain a Buy rating on the stock with a revised SOTP-based PT of Rs. 320.

SOTP Valuation

SBI Bank SOTP	Holding (%)	Valuation Methodology	Value per share	Contribution to TP (%)
SBI Bank - Parent	100%	0.7x FY2023E ABPVS	213	67%
Subsidiaries				
Life Insurance Subsidiary	55.5%	Market Cap post 25% Holdco Discount	40	13%
Cards Subsidiary	69.5%	Market Cap post 25% Holdco Discount	46	14%
AMC Subsidiary	63.0%	5% of AUM as on Sep 2020; 25% Hold-co discount	11	3%
Others			10	3%
		SOTP-based Price Target	**320**	

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	263	1.5	1.2	10.0	7.1	0.5	0.6	8.8	10.0
Punjab National Bank	32	1.1	0.7	64.0	11.4	0.0	0.2	0.7	3.2
Union Bank of India	30	0.3	0.3	14.5	8.6	0.0	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 Website

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