

State Bank of India

13 August 2018

Reuters: SBI.BO; Bloomberg: SBIN IN

High Provisions Not Structural

State Bank of India (SBI) reported its 1QFY19 results with the key strategic pointers being: (1) Provisions jumped 71% YoY to Rs168.49bn, mainly due to Investment Depreciation of Rs 70.98bn. Management re-iterated slippage ratio would be contained within 2% for FY19 (2) Whole bank loan growth was tepid at 5.5% YoY, impacted by LoU ban. Management re-iterated credit growth CAGR of 12% till FY20. (3) Opex increased 20% YoY mainly due to wage revision and gratuity hit. (See [comprehensive analyst meet takeaways](#) for incremental insights). Per se, on the results front, SBI posted Nil growth of 23.8% YoY at Rs218bn, PPOP growth of 0.8% YoY at Rs120bn and a net loss of Rs49bn. We have revised our estimates for FY19/FY20 and retained Buy rating on SBI, revising our target price to Rs353 (from Rs331 earlier) and valuing the stock at 1.4x FY20E P/ABV and Rs85 for subsidiaries.

Several moving parts in asset quality picture but the overall picture is one of material prospective decline in slippages and credit costs: Gross NPA addition was Rs 143.49bn compared with a past-quarter average of Rs 204.42bn. Management re-iterated slippage ratio and credit costs would each be contained within 2%. Of the gross GNPA addition, Rs 43.65bn was due to increase in existing NPA primarily due to devolvement of non-fund exposure. Management explained such devolvement issues would be limited prospectively given current non-fund exposure to corporate and SME NPA is 7.7% of this NPA book. 91% of corporate slippages (Rs37.04bn) were from pre-stated watchlist. Fresh slippages from agri and consumer segment were Rs25.6bn and Rs 19.7bn, respectively. While consumer slippages have trended lower since merger with associates, management is now attempting to have a risk-mitigated but profitable approach for the agri segment. Watchlist, SMA2 and stressed SMA1 taken together, fell QoQ from Rs289.89bn to Rs246.33bn or 1.2% of advances. Management stated that they expected a writeback of ~Rs40bn from NCLT 1 (65% cover on Rs 346bn since resolved cases move out of base) by 30th September and that they were also "over-provisioned" on NCLT 2 cases (79% cover on Rs 284bn). Overall PCR stood at 69.3%. SBI did not avail RBI dispensation on MTM losses and took the entire hit of Rs70.98bn during the quarter. Modified duration of AFS book was 2.83 as of 4QFY18 compared with 1.44 for Bank of Baroda. This has declined to 2.44 as of 1QFY19 (1.33 for BoB).

Whole bank loan growth was relatively tepid at 5.5% YoY, impacted by LoU ban: Domestic loan growth was 7.2% YoY, impacted by a re-classification of ~Rs100bn to UK business. International loans de-grew -4.4% YoY due to a ~Rs450bn reduction in Buyers' Credit on account of LoU. Adjusted for this and including credit substitutes, credit growth stood at 9% YoY. Share of international loans shrunk ~140 bps YoY to 13.4% of whole bank loan book and is expected to move lower to 13% by year-end. Corporate (including SME) grew 5.1% YoY (57% of domestic loans) whereas agri loans de-grew -0.5% YoY (11% share). Consumer loans grew 14% YoY to 32% share, up ~200 bps YoY. Management re-iterated RoA would revert to 0.9%-1.0% by FY20. They have previously stated that RoA guidance is conservative.

Opex growth of 20% YoY was much higher than past run rate but due to one offs: Of the operating expenses of Rs165bn, staff expenses were Rs97bn, which were up 26% YoY. Of the staff expenses, salary was up 5% to Rs71bn. Contribution to employees spiked 180% YoY to Rs25.7bn due to wage revision (Rs5.01bn impact) and gratuity revision hit (Rs9.03bn impact). Employee strength declined 4.8% YoY to 259980 as of 1QFY19 driven by technology initiatives. Share of branches in transaction value fell ~500bps YoY to 18%. The management had previously guided for a cost/income ratio of 45-46% by FY20. Whole bank NIM rose 30 bps YoY aided by interest income of Rs19.5bn due to recovery of 2 large accounts and by 19 bps QoQ decline in cost of deposits to 5.1%. Whole bank deposits growth was 5.8% YoY and domestic deposits (97% of total) grew 5.8% YoY, lagging domestic loan growth. CASA ratio inched up to 45.1% compared with 44.4% an year ago.

Valuation and outlook: We have revised our NII estimates by -3.4%/-0.7% for FY19/FY20, PPOP estimates by -5.1%/-0.9% and PAT estimates by -3.9%/0.3%, respectively. We have valued SBI at 1.4x FY20E P/ABV and Rs85 for subsidiaries, revising our target price on it to Rs353 (from Rs331 earlier).

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BUY

Sector: Banking

CMP: Rs304

Target Price: Rs353

Upside: 16%

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Key Data

Current Shares O/S (mn)	8,924.6
Mkt Cap (Rsbn/US\$bn)	2,717.1/39.5
52 Wk H / L (Rs)	352/232
Daily Vol. (3M NSE Avg.)	23,411,800

Price Performance (%)

	1 M	6 M	1 Yr
SBI	18.1	5.4	8.7
Nifty Index	3.7	8.4	17.

Source: Bloomberg

Y/E March (Rsmn)	1QFY19	1QFY18	4QFY18	YoY (%)	QoQ (%)
Interest income	588,132	549,054	559,413	7.1	5.1
Interest expenses	370,148	372,994	359,670	(0.8)	2.9
Net interest income	217,984	176,060	199,743	23.8	9.1
NIM (%)	2.8	2.4	2.5	44bps	30 bps
Non-interest income	66,795	80,057	124,948	(16.6)	(46.5)
Operating income	284,779	256,117	324,691	11.2	(12.3)
Staff costs	97,084	77,245	92,542	25.7	4.9
Other operating expenses	67,963	60,131	73,317	13.0	(7.3)
Total operating expenses	165,047	137,376	165,859	20.1	(0.5)
Cost to income (%)	58.0	53.6	51.1	432bps	687bps
Operating profit	119,731	118,741	158,832	0.8	(24.6)
Provisions	192,283	89,295	280,961	115.3	(31.6)
PBT	(72,551)	29,446	(122,129)	NA	NA
Tax	(23,793)	9,391	(44,947)	NA	NA
-Effective tax rate (%)	32.8	31.9	36.8	90bps	(401bps)
Net profit	(48,759)	20,055	-77,182	NA	NA
EPS (Rs)	(5.5)	2.3	(8.6)	NA	NA
BV (Rs)	241.0	265.3	245.5	(9.2)	(1.8)
Deposits	27,478,132	26,025,342	27,063,433	5.6	1.5
Advances	18,757,735	18,042,189	19,348,802	4.0	(3.1)

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Comprehensive Analyst Meet Takeaways

- SBI is planning IPO for “at least” 3 of its subsidiaries next year. As a means of price discovery, SBI will sell 4% stake in SBI General Insurance prior to its IPO.
- About 60,000 accounts are opened everyday using SBI’s digital platform.
- The management stated that they transferred ~Rs.100bn to their UK business from the domestic business.
- The ban on LoUs has led to the decline of ~Rs.450bn in buyers’ credit book.
- This quarter’s NII included interest income worth Rs.19.5bn due to recovery of a large account.
- The management stated that their NCLT List 1 is well provided for on all accounts and there is no requirement of incremental provision on it. They are expecting a write-back of ~Rs.40bn by 30th September on this book. In case resolution gets delayed it might happen in the 3rd quarter.
- The management stated that SBI has maintained about 79% provision on their NCLT List 2 exposures. They believe there is strong potential of write-backs occurring on these accounts.
- The management stated that they suffered significant MTM losses in this quarter. Entire MTM hit has been absorbed in this quarter itself, not availing RBI dispensation.
- CRAR position improved with CET 1 ratio improving by 12 bps sequentially. This happened due to improvement in SBI’s risk weighted assets.
- Agri advances declined 0.5% YoY. The management is focusing on risk mitigated products. KCC renewals are there but SBI is seeking to create a more commercially viable agri business.
- Pure MSME loans of the SME portfolio stood at Rs.620bn as of this quarter end. Asset quality wise, Gross NPA ratio has improved in SME book. GST will lead to enabling greater flow of institutional credit in this segment.
- The management stated that SBI is a leader in digital technology in the banking industry with key initiatives focusing on Blockchain, AI, Robotics, and advanced Analytics.
- YONO, SBI’s mobile application, is comparable to global applications. The management stated that this app, which they developed in a relatively short timespan of 15 months, will in the long-run replace physical channels and 5 years down the line, it could become the primary channel. This app also targets the youth who better appreciate online market places.
- The management stated that their BC channels are now at a breakeven level. As more and more money flows through DBT accounts, it will present greater opportunities to cross-sell.
- The management is targeting near PD = 0 clients on their corporate loan book.
- The management is also aiming to create corporate relationships without credit. They believe they have all the products for mid corporate- commercial client groups.
- Modified duration of AFS book has declined from 3.3 to 2.4 in this quarter.
- The management stated that the CRM platform will be implemented in 2-3 months. As a result, lead generation and cross-selling will happen in a systematic manner.
- The management stated that there are a lot of lenders involved in the Samadhan scheme but all are agreeing in unison. Currently, agreement is there on process and price discovery, though, CCI approval and other regulatory approvals will be required. The management expects things to fall into place before the key deadline of 27th August.
- The management believes better outcome is possible in Samadhan than in NCLT. The process of inviting bids, etc is similar and is fully compliant with RBI’s 12th February circular. The management stated that Samadhan are a set of 11 key power assets with PPA.
- The management is expecting a resolution on all their NCLT List 1 cases amounting to Rs.340bn by 30th September. They are awaiting NCLAT order on one of these accounts in the near term.

- On NPA reduction front, the management stated that recoveries and upgrades amounted to Rs.148.5bn in this quarter and rest was transferred to AUCA.
- The management stated that Rs.33bn was recovered from two cases of NCLT List 1. They transferred ~Rs.19.5bn to interest income and the rest to AUCA.
- The management stated that they had already provided fully for the standby LCs that were the main contributors to debit in existing NPA amount. This does not have any impact on provisions.
- Non fund exposure to corporate and SME NPA is about 7.7% of the said NPA book.
- Fresh slippages from agri segment was Rs.25.6bn and from consumer segment was Rs.19.65bn in this quarter.
- The management stated that Sashakt is completely in line with RBI's 12th February circular.
- The management agreed that Rs.700bn worth of power assets in the system that were under stress have now become standard assets.
- Exposure to aviation sector is not more than Rs.35bn as of this quarter end.
- Two big accounts from telecom sector have been recognized as NPAs. One of them forms part of NCLT, while from the other account, payments have started coming in.
- The management stated that the average recovery from the stressed power sector book is expected to be about 50%.
- RBI reviewed 104 accounts with SBI whose further course of action will be known in September. The management stated that their target slippage ratio of 2% and credit costs of 2% will not be violated for the full year of FY19.
- The management stated that the NPA impact of 12th February circular has largely been recognized.
- RWA stood at Rs.17,947.1bn as of this quarter end.
- Total non-fund exposure as of this quarter end stood at Rs.135bn.
- Provision on stressed assets of power sector book stood at 40.5% as of this quarter end. About Rs.40bn needs to be provided on these assets in 2QFY19.
- The management is aiming to align LGD with PCR. PCR requirement as per LGD is 54% and SBI is close to that at 53.38% (excluding AUCA).
- Cash recoveries from their retail book came at Rs.19.21bn and upgradations worth Rs.2.88bn in this quarter.
- The management stated that there was a higher GST payment of Rs.9bn in this quarter leading to lower Other Miscellaneous Income.
- Breakup of provision on investments in this quarter: Rs.6.27bn on non-performing investments, Rs.5.78bn on foreign investments and Rs.58.93bn on g-secs.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Net interest income	571,948	618,597	748,537	864,354	939,076
Pre-provision profit	432,578	508,479	595,110	679,363	808,057
PAT	99,507	104,841	(65,475)	214,322	328,790
EPS (Rs)	12.8	13.1	(7.3)	23.2	35.6
BV (Rs)	185.8	236.2	245.5	271.0	303.6
P/E	18.7	18.2	(32.6)	10.3	6.7
P/BV	1.3	1.0	1.0	0.9	0.8
Gross NPAs (%)	6.5	6.9	10.9	9.9	8.7
Net NPAs (%)	3.8	3.7	5.7	4.5	3.3
RoA (%)	0.5	0.4	(0.2)	0.6	0.9
RoE (%)	7.3	6.3	(3.2)	9.1	12.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	1QFY19	1QFY18	4QFY18	YoY (%)	QoQ (%)	1QFY19E	Devi. (%)
Net interest income	217,984	176,060	199,743	24	9	211,484	3
Pre-provision profit	119,731	118,741	158,832	1	(25)	162,380	(26)
PAT	(48,759)	20,055	(77,182)	NA	NA	7,288	(769)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY19E	FY120	FY19E	FY20E	FY19E	FY20E
Net interest income (Rsmn)	864,354	939,076	895,169	945,735	(3.4)	(0.7)
NIM (%)	2.6	2.8	2.7	2.7	(6bps)	5bps
Operating profit (Rsmn)	679,363	808,057	716,116	815,620	(5.1)	(0.9)
Profit after tax (Rsmn)	214,322	328,790	222,930	327,670	(3.9)	0.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV (adjusting for subsidiaries)



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 5: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Interest income	1,639,983	1,755,182	2,204,993	2,570,207	2,794,299
Interest expenses	1,068,035	1,136,585	1,456,456	1,705,853	1,855,223
Net interest income	571,948	618,597	748,537	864,354	939,076
Fee income	144,160	162,766	229,968	294,586	338,411
Other income	134,294	191,843	216,039	181,663	222,773
Net revenues	850,402	973,206	1,194,544	1,340,602	1,500,260
Operating expenses	417,824	464,728	599,434	661,239	692,203
-Employee expenses	251,138	264,893	331,787	356,496	392,145
-Other expenses	166,686	199,835	267,648	304,744	300,057
Pre-provision profit	432,578	508,479	595,110	679,363	808,057
Provisions	294,836	359,927	750,392	354,632	309,890
-Loan loss provision	298,808	329,056	713,742	304,744	293,289
-Investment depreciation	1,495	2,984	80,876	36,540	-
-Other provisions	(5,467)	27,887	(44,226)	13,349	16,601
PBT	137,742	148,552	(155,282)	324,731	498,167
Tax	38,235	43,711	(89,808)	110,408	169,377
PAT	99,507	104,841	(65,475)	214,322	328,790

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Equity capital	7,763	7,973	8,925	9,247	9,247
Reserves & surplus	1,434,981	1,874,887	2,182,361	2,496,361	2,798,565
Shareholders' funds	1,442,744	1,882,860	2,191,286	2,505,608	2,807,812
Deposits	17,307,225	20,447,514	27,063,433	29,482,033	32,674,585
-Current deposits	1,398,070	1,524,211	1,901,739	2,063,742	2,287,221
-Saving deposits	5,977,461	7,589,614	10,137,745	11,203,173	12,579,715
-Term deposit	9,931,693	11,333,689	15,023,949	16,215,118	17,807,649
Borrowings	3,233,445	3,176,937	3,621,421	2,560,083	3,330,035
Other liabilities	1,592,761	1,552,352	1,671,381	1,695,384	1,674,341
Total liabilities	23,576,174	27,059,662	34,547,520	36,243,108	40,486,774
Cash/equivalent	1,674,676	1,719,716	1,918,986	2,447,623	2,741,338
Advances	14,637,004	15,710,780	19,348,802	21,283,682	23,837,724
Investments	5,756,517	7,659,896	10,609,867	9,574,951	10,677,176
Fixed assets	103,893	429,190	399,923	439,915	483,906
Other assets	1,404,084	1,540,080	2,269,942	2,496,936	2,746,630
Total assets	23,576,174	27,059,662	34,547,520	36,243,108	40,486,774

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

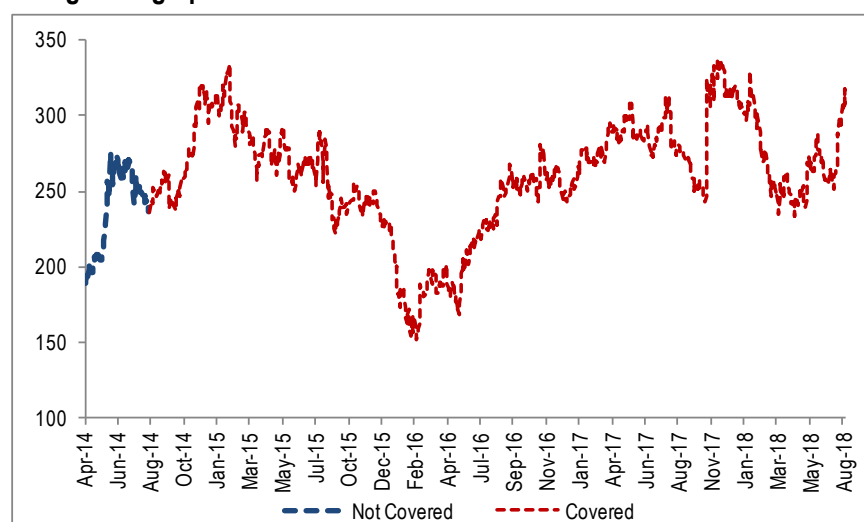
Y/E March	FY16	FY17	FY18	FY19E	FY20E
Growth (%)					
NII growth	4.0	8.2	N.A.	15.5	8.6
Pre-provision profit growth	11.2	17.5	N.A.	14.2	18.9
PAT growth	(24.0)	5.4	N.A.	-427.3	53.4
Business (%)					
Deposits growth	9.8	18.1	N.A.	8.9	10.8
Advances growth	12.6	7.3	N.A.	10.0	12.0
Business growth	11.0	13.2	N.A.	9.4	11.3
Credit deposit	84.6	76.8	71.5	72.2	73.0
CASA deposit	42.6	44.6	44.5	45.0	45.5
Operating efficiency (%)					
Cost-to-income	49.1	47.8	50.2	49.3	46.1
Cost-to-assets	1.9	1.8	1.9	1.9	1.8
Productivity (Rsmn)					
Business per branch	1,903.3	1,987.3	2,070.7	2,259.9	2,515.7
Business per employee	153.8	172.5	175.8	196.8	219.1
Profit per branch	5.9	5.8	-2.9	9.5	14.6
Profit per employee	0.5	0.5	-0.2	0.8	1.3
Spread (%)					
Yield on advances	8.4	7.9	8.1	8.2	8.3
Yield on investments	7.9	7.2	7.7	8.1	8.0
Cost of deposits	6.0	5.6	5.7	5.7	5.7
Yield on assets	8.2	7.7	8.0	8.2	8.2
Cost of funds	5.6	5.1	5.4	5.4	5.5
NIM	2.9	2.7	2.7	2.6	2.8
Capital adequacy (%)					
Tier I	9.9	10.4	10.4	11.4	11.0
Tier II	3.2	2.8	2.2	1.9	1.8
Total CAR	13.1	13.1	12.6	13.2	12.9
Asset quality (%)					
Gross NPAs	6.5	6.9	10.9	9.9	8.7
Net NPAs	3.8	3.7	5.7	4.5	3.3
Specific provision coverage	43.2	48.1	50.4	57.1	64.2
Provision coverage (incl w/off)	60.7	65.9	58.0	64.7	71.4
Slippage	4.6	2.6	9.1	2.0	1.5
Credit costs	2.2	2.2	4.1	1.5	1.3
Return (%)					
RoE	7.3	6.3	-3.2	9.1	12.4
RoA	0.5	0.4	-0.2	0.6	0.9
RoRWA	0.8	0.7	-0.4	1.1	1.5
Per share					
EPS	12.8	13.1	-7.3	23.2	35.6
BV	185.8	236.2	245.5	271.0	303.6
ABV	114.0	123.4	93.5	140.9	192.0
Valuation (x)					
P/E	18.7	18.2	-32.6	10.3	6.7
P/BV	1.3	1.0	1.0	0.9	0.8
P/ABV	2.3	2.1	2.8	1.8	1.3

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
14 August 2014	Buy	2,418	2,915
8 October 2014	Buy	2,411	2,915
17 November 2014	Buy	2,785	3,200
22 December 2014	Buy	304	363
8 January 2015	Buy	301	363
16 February 2015	Buy	308	375
25 May 2015	Buy	282	375
12 August 2015	Buy	268	375
9 November 2015	Buy	244	375
12 February 2016	Buy	155	220
30 May 2016	Buy	201	240
16 August 2016	Buy	244	280
15 November 2016	Buy	272	315
13 February 2017	Buy	275	315
14 February 2017	Buy	272	335
22 May 2017	Buy	309	355
14 August 2017	Buy	280	325
13 November 2017	Buy	333	386
12 February 2018	Buy	296	364
23 May 2018	Buy	254	331
13 August 2018	Buy	304	353

Rating track graph



DISCLOSURES

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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