State Bank of India

# EQUITY REPORT

January 21, 2013

| BSE Code: | 500112 | NSE Code: | SBIN | Reuters Code: | SBI.NS | Bloomberg Code: | SBIN:IN |
|---|---|---|---|---|---|---|---|

**State Bank of India (SBI), India-based, public sector bank incorporated in 1955. As of March 31, 2012, the Bank had a network of 20,193 branches, including 5,096 branches of its 5 associate banks. The company offers a wide range of financial services including life insurance, merchant banking, mutual funds, credit card, factoring, security trading, pension fund management, custodial services, general insurance (non-life insurance) and primary dealership in the money market. Its segments include Treasury, Corporate Banking and Retail Banking.**

## Investor's Rationale

India's largest lender has reported a strong sugre of 17.9% YoY in its loan-book during Q2FY'13, driven by 27.3% YoY and 15% YoY growth in international and domestic loan book respectively. The bank has accelerated its home loan growth by nearly ₹18.00 billion in December as against ₹15.00 billion recorded in November, 2012, after subtracting loan repayments from disbursals. However, it expects the credit growth to be in the 16-18% range primarily driven by home loans growth. Presently, SBI is offering the cheapest home loan rate at 10% p.a. Further, the bank is also in the process of short-listing consultants to introduce a full-swing online home loan application system by April, 2013 which in turn help the borrowers to apply online for home loan and can check their status.

Taking a move ahead, in capital infusion plan for the public sector banks for 2012-13, the Government of India has given a green signal to infuse ₹30.04 billion fund into the country's largest lender State Bank of India to strengthen its capital position. A year ago, the Indian government granted nearly ₹79 billion into SBI, which helped the bank raise its tier I capital to above 8% as mandated by the government. The continuous efforts of the bank to utilize capital efficiently will keep its tier-I ratio healthy over FY13-14E. Thus, the government's plan of infusing fund will help SBI as part of its recapitalization plan to boost the bank's capital base in order to meet the Basel III requirement.

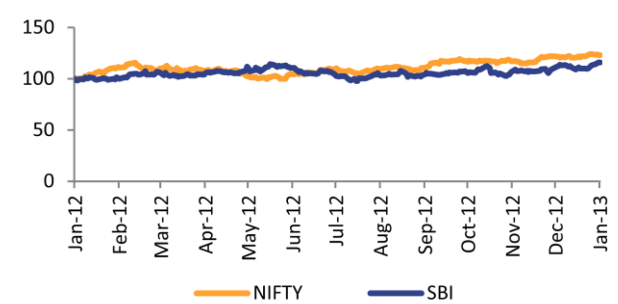
SBI, market leader's asset quality pain has worsened by economic downturn. SBI has incorporated structural changes in its mid corporate credit segment. With this change, we expect that the concerns over asset quality will ease down in the following quarters. Besides, on hopes that RBI will cut lending rates and CRR in an upcoming RBI's third monetary policy review to inject cash, the management is also mulling for cut rate in order to encourage borrowers to take advantage of lower rate of interest.

| Market Data | |
|---|---|
| Rating | **BUY** |
| CMP (₹) | 2,492.05 |
| Target (₹) | **2,990** |
| Potential Upside | ~20.0% |
| Duration | Long Term |
| 52 week H/L (₹) | 2,550/1,800 |
| All time High (₹) | 3,515.0 |
| Decline from 52WH (%) | 2.3 |
| Rise from 52WL (%) | 38.4 |
| Beta | 1.5 |
| Mkt. Cap (₹ bn) | 1,545.0 |
| Book Value (₹ bn) | 1,251.1 |

**Fiscal Year Ended**

| Y/E | FY11A | FY12A | FY13E | FY14E |
|---|---|---|---|---|
| Total Income (₹bn) | 972.2 | 1,208.7 | 1,350.8 | 1,536.7 |
| Net Profit(₹bn) | 82.7 | 117.1 | 142.3 | 173.4 |
| Share Capital | 6.3 | 6.7 | 6.7 | 6.7 |
| EPS (₹) | 130.2 | 174.5 | 212.0 | 258.4 |
| P/E (x) | 19.1 | 14.3 | 11.8 | 9.6 |
| P/BV (x) | 2.4 | 2.0 | 1.8 | 1.5 |
| ROE (%) | 12.7 | 14.0 | 14.9 | 15.7 |
| ROA (%) | 0.7 | 0.9 | 0.9 | 1.0 |

**One year Price Chart**




| Shareholding Pattern | Dec'12 | Sep'12 | Diff. |
|---|---|---|---|
| Promoters | 61.6 | 61.6 | - |
| FII | 9.6 | 9.1 | 0.5 |
| DII | 17.2 | 17.2 | - |
| Others | 11.5 | 12.0 | (0.5) |

## SBI- one of the giant commercial bank in India

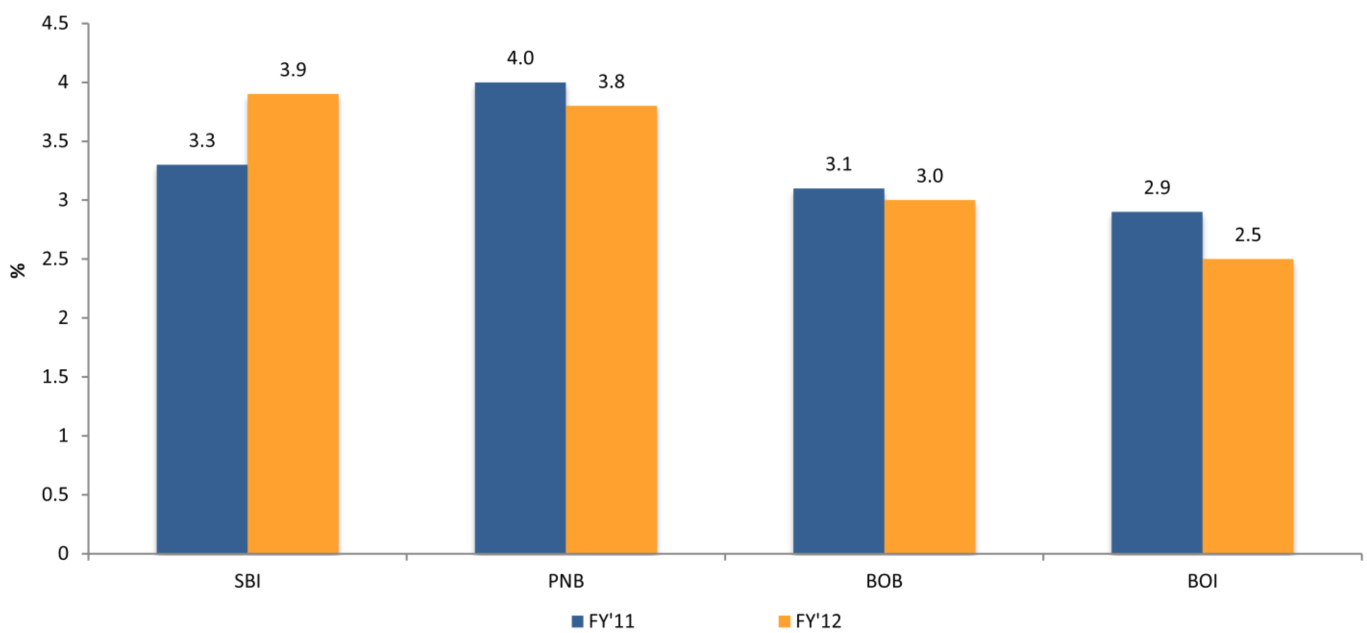
Incorporated in 1955, State Bank of India (SBI), is one of the trusted & the largest commercial public sector bank. The bank has expanded its presence by opening over 20,000 branches and 5 associate banks. Further, the bank offers a wide range of banking and financial services to corporate, institutional, commercial, agricultural, industrial and individual customers throughout India. In addition to banking, the company, through its various subsidiaries, provides a range of financial services, which include life insurance, merchant banking, mutual funds, credit card, factoring, security trading, pension fund management, custodial services, general insurance (non-life insurance) and primary dealership in the money market. Its segments include Treasury, which includes investment portfolio and trading in foreign exchange contracts and derivative contracts; Corporate/Wholesale Banking, which comprises lending activities of Corporate Accounts Group, Mid Corporate Accounts Group and Stressed Assets Management Group; Retail Banking, which comprises of branches in National Banking Group, which includes personal banking activities, including lending activities to corporate customers, and Other Banking Business. As of March 31, 2012, the Bank had a network of 20,193 branches, including 5,096 branches of its five associate banks.

*A leader in banking services having 20,000 branches and 5 associate banks*

Despite of sluggish environmental circumstances, the bank witnessed a massive growth in its net Profit and stood at ₹117.1 billion in FY'12, up by 41.7% from ₹82.65 billion in FY'11. Further, the operating profit of the bank crossed ₹300 billion mark, rising by 24.62% to ₹315.7 billion in FY'12 from ₹253.4 billion, indicating that core operations remain robust. SBI is the only PSB to post an expansion of 50bps YoY in its net interest margin (NIM) in FY'12 as compared to other PSB. Thus, we believe that the NIM improvement helped it to provide cushion to its one-off provisions without impacting profitability. Notably, despite re-pricing its loans by hiking base rate faster than the industry during FY12, SBI's base rate remains among the lowest in the industry.

*The various segments of the bank includes Treasury, Corporate Banking and Retail Banking.*

**SBI records highest NIM among peers**



*SBI has logged a notable growth of 30.2% YoY in its Q2FY'13 net profit at ₹36.6 billion led by sharp decline in provisions for bad loans.*

*The bank has logged fresh slippages of ₹84.95 billion as compared to ₹108.4 billion in Q1FY'13.*

*The loan book of the bank during Q2FY'13 surged by 17.9% YoY and stood at ₹9,560.0 billion.*

*The government had infused ₹7,900 crore in SBI to increase the tier-I capital of the country's largest bank.*

*According to the RBI guidelines on Basel III seeks Indian banks to maintain a minimum 5.5% in common equity by March 31, 2015 against 3.6% now.*

## Next quarter- expectations for 16% to 18% loan growth

SBI has logged a notable growth of 30.2% YoY in its Q2FY'13 net profit at ₹36.6 billion led by sharp decline in provisions for bad loans by 46.1% YoY at ₹18.3 billion and better credit management. Besides, write-back of provisions worth ₹2.60 billion, which was made for investment depreciation, coupled with recoveries from bad loans also boosted profitability. The bank posted a muted growth of 4.7% YoY in Q2FY'13 Net Interest Income (NII) at ₹109.74 billion on account of stable yields and higher cost of funds while non-interest income was down 2.4% YoY, mainly due to 5.8% YoY and 33.5% YoY fall in fee income and forex income respectively. However, the bank's domestic as well as international NIMs, decreased by 9bps and 19bps sequentially to 3.77% and 1.58%, respectively, which led to contraction of 12bps in overall NIM of the bank on QoQ basis to 3.45% in Q2FY'13.

On asset quality front, the bank witnessed an intense pressure as its ratio of gross non-performing assets (NPAs) to gross advances increased by 96bps YoY and 16bps QoQ to 5.2% or to ₹492.0 billion in Q2FY'13, owing to higher slippages. The bank has logged fresh slippages of ₹84.95 billion as compared to ₹108.4 billion in Q1FY'13. Besides, the bank's restructured assets portfolio of ₹404.5 billion, about 19.0% have slipped into NPA during the quarter ended September 2012.

The loan book of the bank during Q2FY'13 surged by 17.9% YoY and stood at ₹9,560.0 billion, driven by 27.3% YoY and 15% YoY growth in international and domestic respectively. Further, deposits grew by 16.5%YoY at ₹11,336.44 billion. Meanwhile, the bank remains optimistic of achieving a 16% to 18% credit growth in the next quarter assisted by consumer credit growth, home loans and car loans.

## Banks saviour- Governments capital infusion

The former Finance Minister, Mr Pranab Mukherjee, had in the Budget 2012-13 has set aside about ₹ 158.88 billion for recapitalisation of banks during the current fiscal. SBI, is expecting to raise ₹30 billion through preference shares by the end of FY'13E, but ruled out the possibility of it coming out with a rights issue.

The fund infusion will help bank ramp up its capital base to over 13.0%. In March 2012, the government had infused ₹79.00 billion in SBI to increase the tier-I capital of the country's largest bank. With this, the Tier-1 Capital Adequacy Ratio, which is the bedrock of a bank's strength, rose from 7.77% to 9.79% during this period. Specifically, the Capital Adequacy Ratio for the Bank increased from 11.98% in March'11 to 13.86% in March'12. Also, the government's holding in the bank has elevated to 61.58% from 59.4%. Thus, the governments nod for fund infusion is going to help the banks as a savior and help them to freely implement their certain business expansion plans. Consequently, with the capital charge and the implementation of BASEL III norms, the government's plan of infusing fund will help SBI as part of its recapitalization plan to boost the bank's capital base in order to meet the Basel III requirement.

According to the RBI guidelines on Basel III seeks Indian banks to maintain a minimum 5.5% in common equity by March 31, 2015 against 3.6% now. Besides, the local lenders could have to raise more funds as various capital instruments are likely to be excluded under Basel III definition, for eg. Perpetual debt. So the challenge for banks is not in transitioning to Basel III, but in their capital-raising ability, as the proposed norms are likely to force banks to plough back a larger chunk of their profit into the balance sheet, which could impact their return on equity.

*As of end-March 2012, Gross NPAs of the bank stood at 4.44%. Net NPAs that had risen to 2.22% in December 2011 also fell by 2% to 1.82% at the end of March 2012.*

*Almost 77% of the incremental slippages were witnessed in the mid-corporate and SME segments.*

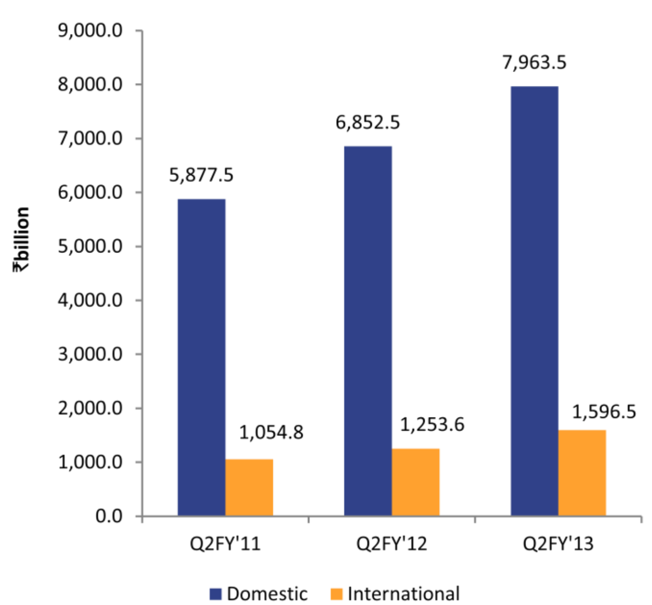
*Bad loans of the bank to steel, textile and trading companies account for more than one-fifth of SBI's soured debt.*

## Asset quality- a mounting burden

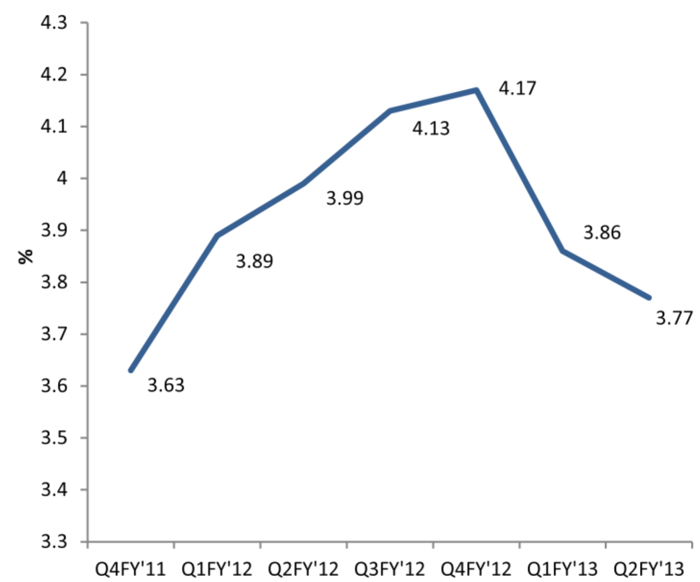
Along with robust growth, the bank has ensured that asset quality is maintained. As of end-March 2012, Gross NPAs of the bank stood at 4.44%. Net NPAs that had risen to 2.22% in December 2011 also fell below the psychological threshold of 2% to 1.82% at the end of March 2012. On the other hand, Provision Coverage Ratio (PCR) improved to 68.10% in March 2012 from 64.95% in March 2011, reflecting its abundant prudence and caution. However, during Q2FY'13, the bank's asset quality was under intense pressure, mainly because of rising slippages, which came at 3.3% though lower than 5.0% in Q1FY'13 and 4.2% in Q2FY'12. Almost 77% of the incremental slippages were witnessed in the mid-corporate (43% of fresh slippages) and SME segments (34% of fresh slippages). Increase in slippages led the stress at near-peak levels, especially in the mid-corporate segment. Besides, from the bank's restructured assets portfolio of ₹404.5 billion, about 19.0% have slipped into NPA during the quarter ended September 2012.

Stressed assets at SBI, which include gross non-performing loans and restructured debt, rose to 5.98% of total loans as of September 2012 from 5.58% a year earlier. Bad loans to steel, textile and trading companies account for more than one-fifth of SBI's soured debt, out of which it recovered more than ₹5 billion of written-off loans in Q2FY'12. SBI is already treating its Kingfisher Airline (KFA) account as doubtful asset, the second level of non-performing asset wherein provisioning requirement is 30% and above. With the incorporated structural changes in its mid corporate credit segment, we expects that the concerns over asset quality are close to bottoming out in the future.

### Composition of advance growth




### Movement in domestic NIM

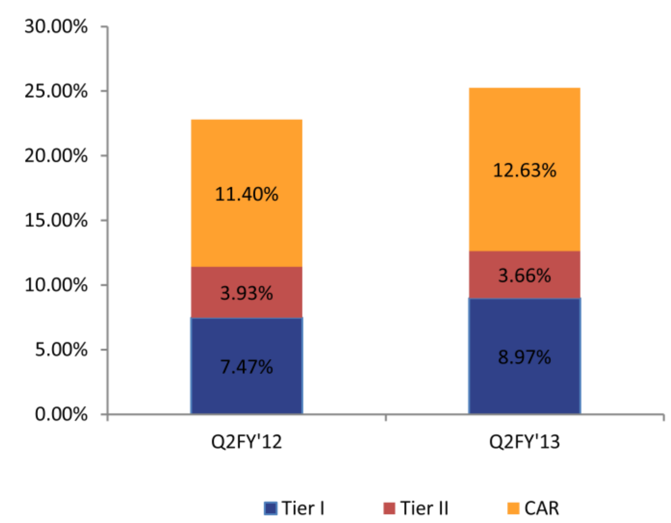


*Though maintaining asset quality is a concern for the bank and hence taken various measures to overcome the problem*

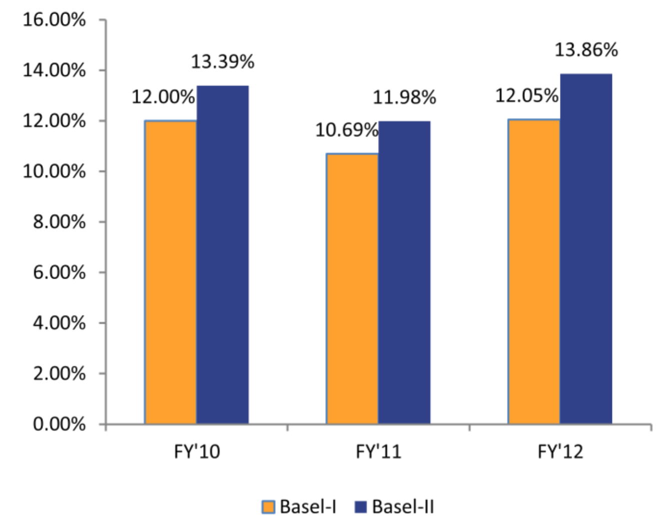
## Strategic initiatives to overcome the triggering asset quality

SBI has taken various new initiatives that will help to improve the asset quality. Firstly, it has converted the structure of credit processing cell (CPC), a factory type of system wherein credit proposals used to be processed to accounts management team (AMT). Secondly, new AMT setup both the post and pre sanction formalities will be done under one roof as post sanction actions should be very strong for the bank in terms of follow-up and monitoring of the advances for healthy asset quality. Thirdly, to support the growing demand from the retail segment and grab the huge potential available in the market, the bank has stepped-in forcely to generate a comprehensive electronic payment infrastructure to activate, 108 million debit cards and has entered into Merchant Acquiring Business (MAB). Last but not the least, higher recovery up-gradation would ensure better asset quality in the coming quarters.

**Composition of CAR ratio**




**Capital adequacy ratio (CAR)**




*The bank witnessed a surge in home loan growth by nearly ₹18.0 billion in December as against ₹15.0 billion recorded in November, 2012.*

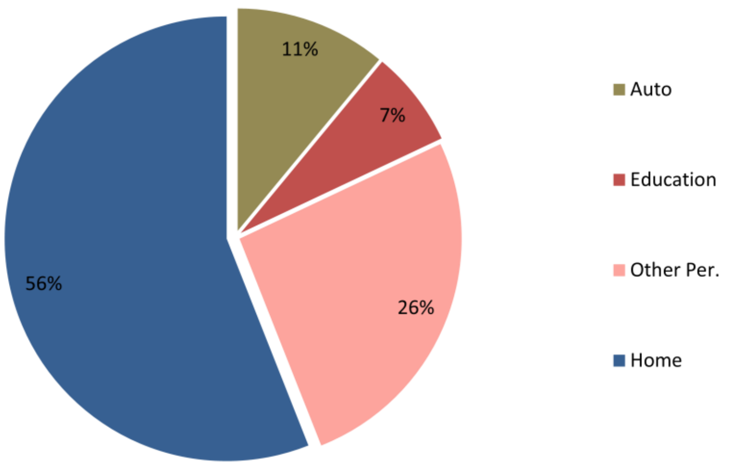
## Retail loan growth- spurts balance sheet

SBI, currently offering the cheapest home loan rate at 10% p.a. has witnessed a surge in home loan growth by nearly ₹18.0 billion in December as against ₹15.0 billion recorded in November, 2012. Within two months of cutting rates on home and auto loans by 25-50 basis points, the country's largest lender, is seeing a major growth in these segments. While home loan applications have nearly tripled, demand for auto loans has risen four-fold. SBI's outstanding growth for home loans stood at around ₹1.13 lakh crore as December 31, 2012. With stressed asset quality from its mid corporate credit segment, the lender decided to focus on retail loans wherein the risk of defaults is mitigated. The bank’s retail book is contributing significantly. During Q2FY’13, retail advances of the bank grew by 13.63%YoY at ₹1,917.60 billion. This has been made possible right sourcing, processing and sanctioning of home loan products. Each segment is working in sync with the other.

SBI had seen a slump in its retail loan growth in FY12, following the withdrawal of the controversial 'teaser loan' products, but its recent cuts in retail lending rates have pushed up credit growth for the bank again. The home loan portfolio stands at ₹1.8 lakh crore and the bank expects it to cross ₹2 lakh crore by 2015.

Further, the bank is in the process of short-listing consultants to introduce a full-swing online home loan application system by April, 2013. This will not only enable borrowers to apply for home loan online but also they can check their status. Customers may only need to visit the branch at the time of submitting physical documents.

**Break-up of retail loan**




## Decision of CRR and repo rate cut- silver lining for banks

*RBI's monetary policy review, is likely cut interest rates by 0.5% and CRR by up to 1% to bolster growth.*

Concerned over the slowing growth of the economy, bankers have unanimously called for a cut in interest rate and cash reserve ratio in Reserve Bank of India (RBI)'s third monetary policy review due on January 29 2013. SBI expressed hope that the central bank will slash the interest rates by 0.5% and CRR by up to 1% to boost sagging growth. However, reduction in the repo rate, the rate at which Reserve Bank of India lends to banks, alone will not lead to a lower interest rate across the system, but it should be accompanied by lower CRR, which releases cash to banks who are borrowing from the RBI to meet liquidity tightness.

*Banks are demanding a cut in rate in the backdrop of tight liquidity conditions.*

In the backdrop of tight liquidity conditions, the expectation of a rate cut is rising with inflation easing to a three-year low. But the 10% retail price acceleration in November and the record high current account deficit, the excess of spending overseas than earning, are tempering hopes. The apex bank has hinted that it could go in for an interest rate cut in the review, making its first cut in nine months on the back of slowing inflation and weak economic activity. SBI expects RBI to allow banks to give 2% interest on current accounts deposits, to attract cash. The bank may soon take a final call over cut in base rate based on three key areas: cost of funds, net interest margin and a cue for RBI's January policy.

## Balance Sheet (Standalone)

| Y/E (₹billion) | FY11A | FY12A | FY13E | FY14E |
|---|---|---|---|---|
| Equity Capital | 6.3 | 6.7 | 6.7 | 6.7 |
| Reserves & Surplus | 643.5 | 832.8 | 948.2 | 1,094.8 |
| Shareholders' Fund | 649.9 | 839.5 | 954.9 | 1,101.5 |
| Deposits | 9,339.3 | 10,436.5 | 12,127.2 | 14,043.3 |
| Borrowings/Advances | 1,195.7 | 1,270.1 | 1,456.8 | 1,638.8 |
| Other Liabilities & Provisions | 1,052.5 | 809.2 | 849.6 | 883.6 |
| Total liabilities | **12,237.4** | **13,355.2** | **15,388.5** | **17,667.2** |
| Cash & Bank Balance | 944.0 | 540.8 | 562.4 | 601.8 |
| Money at call and short notice | 284.8 | 430.9 | 446.0 | 472.7 |
| Investments | 2,956.0 | 3,122.0 | 3,715.2 | 4,346.7 |
| Advances | 7,567.2 | 8,675.8 | 10,047.7 | 11,604.1 |
| Fixed Assets | 47.6 | 54.7 | 59.6 | 62.0 |
| Other Assets | 437.8 | 531.1 | 557.7 | 580.0 |
| **Total Assets** | **12,237.4** | **13,355.2** | **15,388.5** | **17,667.2** |

## Profit & Loss Account (Standalone)

| Y/E (₹billion) | FY11A | FY12A | FY13E | FY14E |
|---|---|---|---|---|
| Interest Income | 813.9 | 1,065.2 | 1,192.0 | 1,358.9 |
| Interest Expended | 488.7 | 632.3 | 733.5 | 825.2 |
| **Net Interest Income** | **325.3** | **432.9** | **458.5** | **533.7** |
| Growth (%) | | *33.1* | *5.9* | *16.4* |
| Other Income | 158.2 | 143.5 | 158.8 | 177.9 |
| Operating Income | 483.5 | 576.4 | 617.3 | 711.6 |
| Growth (%) | | *19.2* | *7.1* | *15.3* |
| Operating Expenses | 230.2 | 260.7 | 286.8 | 324.6 |
| **Operating Profit** | **253.4** | **315.7** | **330.5** | **386.9** |
| Growth (%) | | *24.6* | *4.7* | *17.1* |
| Operating Margins (%) | *26.1* | *26.1* | *24.5* | *25.2* |
| Provisions & Contingencies (including tax) | 170.7 | 198.7 | 188.3 | 213.5 |
| **Net Profit** | **82.7** | **117.1** | **142.3** | **173.4** |

## Key Ratios (Standalone)

| Y/E | FY11A | FY12A | FY13E | FY14E |
|---|---|---|---|---|
| Avg. Cost of deposits (%) | 5.2 | 6.1 | 6.0 | 5.9 |
| ROE | 12.7 | 14.0 | 14.9 | 15.7 |
| ROA | 0.7 | 0.9 | 0.9 | 1.0 |
| Interest Expense / Interest Income | 60.0 | 59.4 | 61.5 | 60.7 |
| Investment/Deposit | 0.32 | 0.30 | 0.31 | 0.31 |
| Cost-Income Ratio (%) | 47.6 | 45.2 | 46.5 | 45.6 |
| C-D Ratio (%) | 81.0 | 83.1 | 82.9 | 82.6 |
| BVPS | 1,023.4 | 1,251.1 | 1,423.1 | 1,641.5 |
| P/BV | 2.4 | 2.0 | 1.8 | 1.5 |
| EPS | 130.2 | 174.5 | 212.0 | 258.4 |
| P/E | 19.1 | 14.3 | 11.8 | 9.6 |

## Valuation and view

Considering the bank's leading position, we believe that SBI will outperform its peers on account of its stronger core competitiveness to deliver healthy earning growth, while managing its provisioning requirements. However, stressed asset quality, steep contraction in margins coupled with slowdown in economic growth remains a major concern for the bank. But with the bank's effort to take several measures to ensure better asset quality, we expect SBI to bottom-out concern over stressed asset quality in near term.

At a current CMP of ₹2,492, SBI is attractively placed at P/BV of ~1.5x FY14E. Considering the above aspects, we rate the stock as 'BUY' with a potential upside of 20% for the coming 12 months.

Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

**Disclaimer**



**This report and Information contained in this report is solely for information purpose and may not be used as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. The investment as mentioned and opinions expressed in this report may not be suitable for all investors. In rendering this information, we assumed and relied upon, without independent verification, the accuracy and completeness of all information that was publicly available to us. The information has been obtained from the sources that we believe to be reliable as to the accuracy or completeness. While every effort is made to ensure the accuracy and completeness of information contained, Indbank Limited and its affiliates take no guarantee and assume no liability for any errors or omissions of the information. This information is given in good faith and we make no representations or warranties, express or implied as to the accuracy or completeness of the information. No one can use the information as the basis for any claim, demand or cause of action.**

**Indbank and its affiliates shall not be liable for any direct or indirect losses or damage of any kind arising from the use thereof. Opinion expressed is our current opinion as of the date appearing in this report only and are subject to change without any notice.**

**Recipients of this report must make their own investment decisions, based on their own investment objectives, financial positions and needs of the specific recipient. The recipient should independently evaluate the investment risks and should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document and should consult their advisors to determine the merits and risks of such investment.**

**The report and information contained herein is strictly confidential and meant solely for the selected recipient and is not meant for public distribution. This document should not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced, duplicated or sold in any form.**