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State Bank of India (SBI)

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Best placed among public sector banks

SBI is India's largest commercial bank and holds ~20% market share in the banking sector. It has 24,017 branches in India along with 198 overseas branches spread over 37 countries. The bank has achieved consistent growth over the last 5 years (FY12-17) with a CAGR of 15% in total assets, 14% in total deposits, 13% in total advances and 7% in net interest income (NII).

Investment Rationale

- **Retail segment to drive loan growth:** SBI's advances grew at a CAGR of 13% over FY12-17 driven by 15% growth in domestic corporate advances. The bank has decided to focus more on retail advances and high rated clients in its corporate loan book. This would help the bank to improve its asset quality in the future. We expect SBI's advances to grow at a healthy CAGR of 12% over FY17-19E mainly led by financing of operational projects and retail loans.

- **Strong retail liability franchise:** Over the last five years, SBI has continuously focussed on maintaining low cost retail deposits. This has helped the bank in sustaining the current accounts savings account (CASA) ratio consistently over 40% levels. We expect deposits will continue to grow at a healthy CAGR of 13% over FY17-19E mainly led by retail deposits.

- **Return ratios to improve:** SBI's return ratios remained under pressure on the back of higher operating expenses coupled with higher credit cost due to deteriorating asset quality. However, the bank has taken several measures to improve its operating efficiency. It will help the bank to improve its RoE to 9% and RoA to 0.6% by FY19E.

- **Asset quality trends to show gradual improvement:** SBI's asset quality deteriorated significantly over FY16-17 on account of RBI's asset quality review (AQR) activity. However, as per the bank's management, it has recognized all the known stress from the loan book. Therefore, We expect Gross NPA/Net NPA ratios to improve to 5.7%/2.7% by FY19E.

- **Merger of associate banks with SBI is long term positive:** SBI merged all its five banking associates into parent with effect from April 01, 2017. We expect the merger will lead to synergy and increase balance sheet strength as well as profitability from a long-term perspective. Notably, branch rationalization would be one of the key synergy benefits from the merger in a short-term perspective.

Valuation: We believe that SBI is likely to be a major beneficiary of the economic recovery and is best positioned to capitalize on growth opportunities owing to its strong capital base coupled with relatively lower NPAs among public sector banks (PSBs). Further, stake sale in subsidiaries and disinvestment of non-core assets will provide a cushion to earnings. Therefore, we continue to remain positive on SBI and maintain 'BUY' rating on the stock with a target price Rs325 based on sum of the parts (SOTP) methodology where we value its standalone business at Rs272 (P/ABV of 1.4x for FY19E) and subsidiaries at Rs53 (holding company discount: 20%).

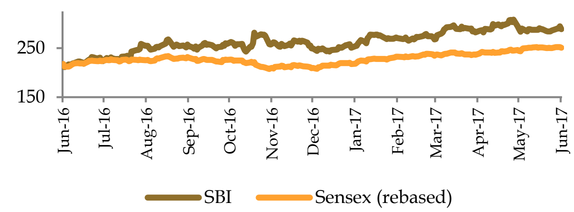
Market Data

Rating	**BUY**
CMP (Rs.)	289
Target (Rs.)	325
Potential Upside	12%
Duration	Long Term
Face Value (Rs.)	1
52 week H/L (Rs.)	315/203
Adj. all time High (Rs.)	315
Decline from 52WH (%)	8.3
Rise from 52WL (%)	42.4
Beta	0.9
Mkt. Cap (Rs.Cr)	249,337

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Interest Income (Rs.Cr)	163,685	175,518	197,932	219,104
Interest Expense (Rs.Cr)	106,804	113,659	130,719	144,420
Net Interest Income (Rs. Cr)	56,881	61,860	67,213	74,684
Pre Pro Profit (Rs. Cr)	43,257	50,848	50,867	56,214
EPS	12.8	13.1	17.4	22.7
P/E (x)	22.5	22.0	16.6	12.7
P/BV (x)	1.6	1.2	1.2	1.1
P/ABV (x)	2.6	1.8	1.6	1.4
ROE (%)	7.3	6.3	7.2	8.7
ROA (%)	0.5	0.4	0.5	0.6

One year Price Chart



Shareholding Pattern	Mar-17	Dec-17	Chg.
Promoters (%)	62.2	61.2	0.1
Public (%)	37.8	38.8	(0.1)

SBI is the largest commercial bank in India with over 1/5th market share of Indian banking sector.

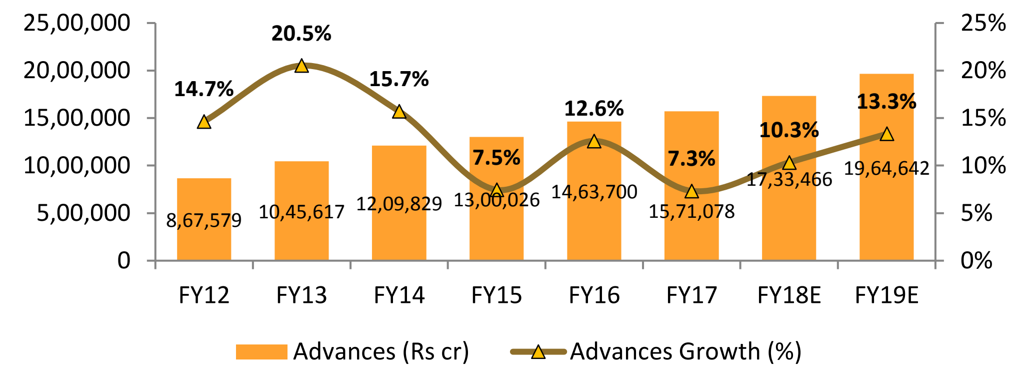
State Bank of India (SBI) - Company Overview

SBI is India's largest commercial bank and holds ~20% market share in the banking sector. It has 24,017 branches in India along with 198 overseas branches spread over 37 countries. The bank has achieved consistent growth over the last 5 years (FY12-17) with a CAGR of 15% in total assets, 14% in total deposits, 13% in total advances and 7% in net interest income (NII).

Retail segment to drive loan growth

SBI's advances grew at a CAGR of 13% over FY12-17 driven by 15% growth in domestic corporate advances. Retail continued to show impressive growth (17% CAGR over FY12-17), driven by both housing / mortgage loans and auto loans. However, SBI remained conservative in growing Agri/SME (5%/9% CAGR over FY12-17) advances. Overseas loan book (18% of total loan book) grew at a much faster pace of 16% CAGR over FY12-17 as compared to 13% CAGR reported in domestic loan book. Going forward, the bank has decided to focus more on retail advances and high rated clients in its corporate loan book. This would help the bank to improve its asset quality in the future. We expect SBI's advances to grow at a healthy CAGR of 12% over FY17-19E mainly led by financing of operational projects and retail loans.

Advances to grow at a CAGR of 12% over FY17-19E

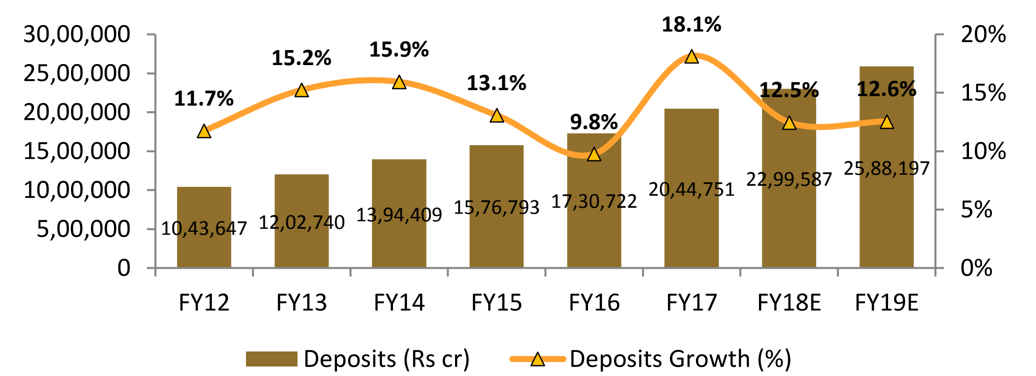


Source: Company, In-house research

Strong retail liability franchise

Over the last five years, SBI has continuously focused on maintaining low cost retail deposits. This has helped the bank in sustaining the current accounts savings account (CASA) ratio consistently over 40% levels. We expect the traction in CASA deposits to continue as the bank has the highest branch network in the country with 24,017 branches, of which 65% are in rural and semi-urban areas. As a result, ~20% of the banked population has their accounts with SBI. Therefore, we expect deposits will continue to grow at a healthy CAGR of 13% over FY17-19E mainly led by retail deposits.

Deposits to grow at a CAGR of 13% over FY17-19E

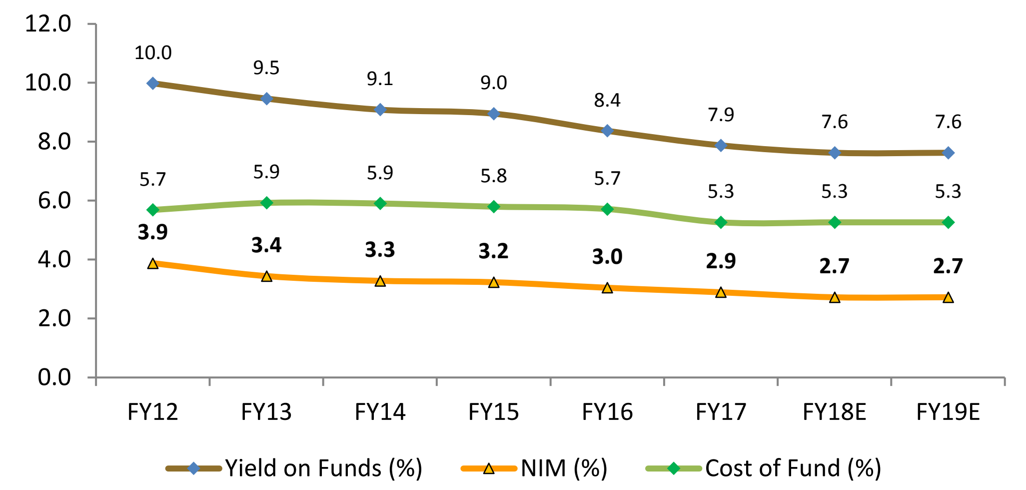


Source: Company, In-house research

Net Interest Margin (NIM) to stabilize

NIM of SBI has declined consistently over the last five years due to higher slippages coupled with lower credit to deposits (c/d) ratio. Although we estimate NIM to decline further given the rising proportion of loans linked to marginal cost of funds based lending rate (MCLR), however, it will be stabilizing around 2.7% on account of steady CASA, improving c/d ratio and lower slippages.

NIM to decline further but to stabilize around 2.7% over FY17-19E

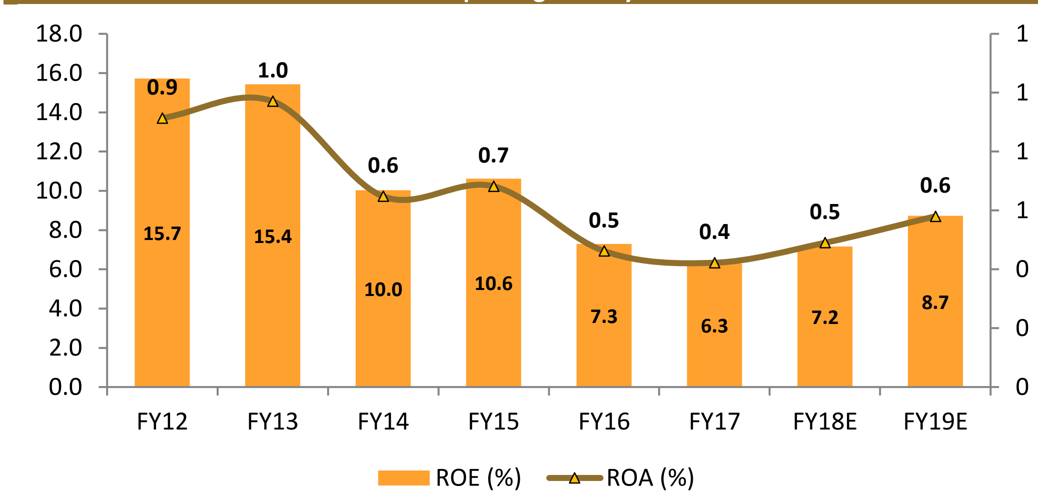


Source: Company, In-house research

Return ratios to improve

SBI's return ratios remained under pressure on the back of higher operating expenses coupled with higher credit cost due to deteriorating asset quality. However, the bank has taken several measures to improve its operating efficiency. The bank moved its overseas treasury operations to centralized location from 21 locations which helped the bank to reduce its treasury operations cost. Going forward, we expect net profit to gain strong traction (31% CAGR over FY17-19E) aided by controlled credit cost and lower C/I ratio of ~49% by FY19E. It will also help the bank to improve its RoE to 9% and RoA to 0.6% by FY19E.

Return ratios to improve gradually over FY17-19E

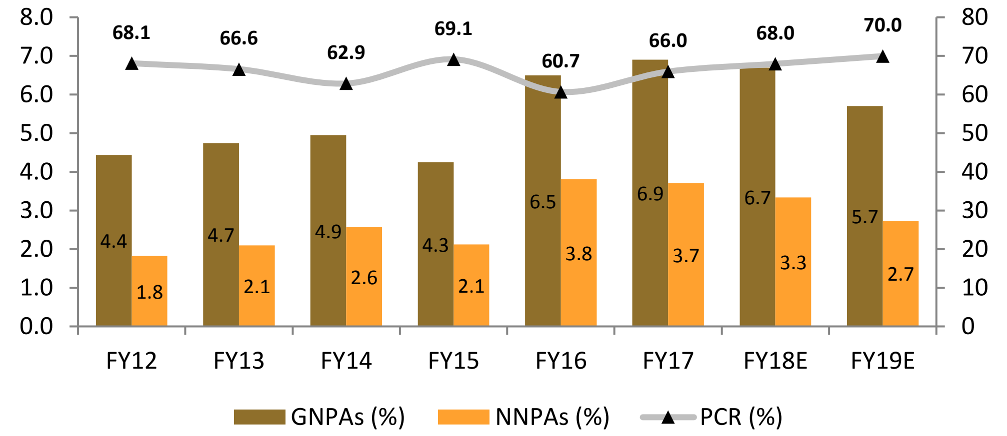


Source: Company, In-house research

Asset quality trends to show gradual improvement

SBI's asset quality deteriorated significantly over FY16-17 on account of RBI's asset quality review (AQR) activity. However, as per the bank's management, it has recognized all the known stress from the loan book. Additionally, SBI has one of the smallest watch-list of stressed accounts which is 1.6% of advances as of FY17 as compared to 2.3% as of FY16 which also implies lower stress henceforth. Further, higher provision coverage ratio provides additional comfort. As the bank has already identified most of the stressed accounts as NPA over FY16-17, we expect the bank's asset quality to improve gradually but steadily from hereon.

Asset quality to improve over FY17-19E

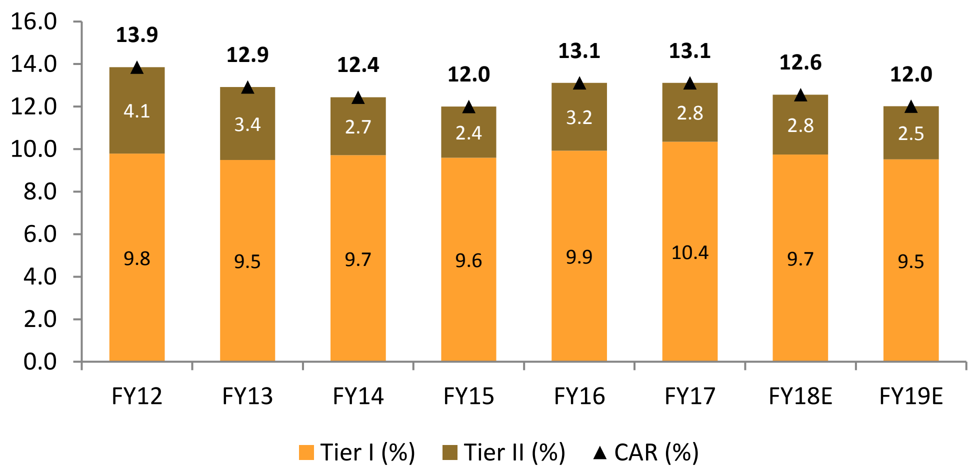


Source: Company, In-house research

Adequately capitalized

SBI's capital adequacy ratio (CAR) as per Basel III norms continues to remain strong at 13.1% (one of the highest among PSBs) with Tier-I capital ratio of 10.4%. This will help the bank to grow its business faster as compared to other public-sector banks (PSBs).

Well capitalized to support growth momentum over FY17-19E



Source: Company, In-house research

Merger of associate banks with SBI is long term positive

SBI merged all its five banking associates into parent with effect from April 01, 2017. We expect the merger will lead to synergy and increase balance sheet strength as well as profitability from a long-term perspective. Notably, branch rationalization would be one of the key synergy benefits from the merger in a near-term perspective.

Outlook and Valuation

We believe that SBI is likely to be a major beneficiary of the economic recovery and is best positioned to capitalize on growth opportunities owing to its strong capital base coupled with relatively lower NPAs among public sector banks (PSBs). Further, stake sale in subsidiaries and disinvestment of non-core assets will provide a cushion to earnings. Hence, we expect net profit to gain strong traction (31% CAGR over FY17-19E) aided by controlled credit cost and pick-up in loan growth. While most of the PSBs have shown decline in their market share recently, SBI has gained market share along with superior business growth.

Therefore, we continue to remain positive on SBI and maintain 'BUY' rating on the stock with a target price Rs325 based on sum of the parts (SOTP) methodology where we value its standalone business at Rs272 (P/ABV of 1.4x for FY19E) and subsidiaries at Rs53 (holding company discount: 20%).

Sum of the parts (SOTP) valuation

	Methodology	Valuation	Value Per Share (Rs)
SBI	1.4x FY19E ABV	217,630	272
SBBJ	0.5x FY19E ABV	3,409	3
SBH	0.5x FY19E ABV	4,740	6
SBM	0.5x FY19E ABV	1,909	2
SBP	0.5x FY19E ABV	2,292	3
SBT	0.5x FY19E ABV	3,346	3
Others		29,338	49
	20% holding discount to subsidiaries		-14
	Target Price		**325**

Source: In-house research

Key Risks:

- **Increase in slippages:** We have factored in the slippages of 2.4% and 1.8% for FY18E and FY19E, respectively. Increase in slippages beyond our estimates will deteriorate asset quality and will increase credit cost and hence affect the bottom line.
- **Lower growth than expected:** We expect loan growth of 12% over FY17-19E largely led by higher growth in retail assets. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.
- **Management change:** The term of present chairman of SBI will end in September 2017. So, change in management may bring change in the bank's present strategy which can have negative as well as positive risk on the stock price.

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	163,685	175,518	197,932	219,104
Interest Expense	106,804	113,659	130,719	144,420
Net Interest Income	**56,881**	**61,860**	**67,213**	**74,684**
Non Interest Income	28,158	35,461	36,598	35,539
Net Income	**85,040**	**97,321**	**103,811**	**110,223**
Operating Expenses	41,782	46,473	52,944	54,009
Total Income	**191,844**	**210,979**	**234,530**	**254,643**
Total Expenditure	**148,586**	**160,131**	**183,662**	**198,429**
Pre Provisioning Profit	43,257	50,848	50,867	56,214
Provisions	29,484	35,993	29,816	28,821
Profit Before Tax	**13,774**	**14,855**	**21,052**	**27,392**
Tax	3,823	4,371	7,156	9,311
Net Profit	**9,950**	**10,484**	**13,896**	**18,082**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Liabilities				
Capital	776	797	797	797
Reserves and Surplus	143,498	187,489	198,782	214,076
Deposits	1,730,722	2,044,751	2,299,587	2,588,197
Borrowings	224,191	317,694	303,357	294,696
Other Liabilities and Provisions	159,876	155,235	162,997	171,147
Total Liabilities	**2,259,063**	**2,705,966**	**2,965,521**	**3,268,913**
Assets				
Cash and Balances	167,468	171,972	183,967	207,056
Investments	477,097	765,990	869,244	918,163
Advances	1,463,700	1,571,078	1,733,466	1,964,642
Fixed Assets	10,389	42,919	42,919	42,919
Other Assets	140,408	154,008	135,925	136,133
Total Assets	**2,259,063**	**2,705,966**	**2,965,521**	**3,268,913**

Key Ratios (Standalone)

Y/E	FY16	FY17	FY18E	FY19E
Per share data (Rs.)				
EPS	17.5	12.8	13.1	17.4
DPS	3.5	2.6	2.6	2.8
BV	172.0	185.9	236.1	250.3
ABV	135.1	111.1	163.1	177.7
Valuation (%)				
P/E	22.5	22.0	16.6	12.7
P/BV	1.6	1.2	1.2	1.1
P/ABV	2.6	1.8	1.6	1.4
Div. Yield	0.9	0.9	1.0	1.0
Capital (%)				
CAR	13.1	13.1	12.6	12.0
Tier I	9.9	10.4	9.7	9.5
Tier II	3.2	2.8	2.8	2.5
Asset (%)				
GNPA	6.5	6.9	6.7	5.7
NNPA	3.8	3.7	3.3	2.7
PCR	60.7	66.0	68.0	70.0
Management (%)				
Credit/ Deposit	84.6	76.8	75.4	75.9
Cost/ Income	49.1	47.8	51.0	49.0
CASA	43.8	45.6	44.0	42.5
Earnings (%)				
NIM	3.0	2.9	2.7	2.7
ROE	7.3	6.3	7.2	8.7
ROA	0.5	0.4	0.5	0.6

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* SBI is a large-cap bank

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