29 November 2023

the CornerOffice
Interaction with the CEO

Business outlook steady; internal accruals to support growth momentum

Aiming for sustainable RoA/RoE of ~1.2%/20%

We organized an interactive session with Mr. Dinesh Kumar Khara, Chairman, State Bank of India (SBIN), to understand the impact on the bank's capital adequacy and growth plans after the recent increase in risk weight (RWA) by the RBI, and to discuss its margin outlook and progress on stated objectives. Here are the key highlights:

Well placed to absorb the impact on CET-1 (49bp impact) due to increase in RWA

SBIN indicated that the recent increase in RWA by the RBI should not pose any significant challenge for the bank. The overall impact is estimated to be 49bp – of which 28bp is attributed to unsecured loans and 21bp is due to lending to NBFCs (we earlier in our report estimated the impact to be at 44bp). The bank believes that it is well placed to absorb this impact, as its full year profit will keep CET-1 in the comfortable zone. The bank's CET-1 ratio, including 1H profits, stands at 11.03%, and after this impact, it will still be fairly comfortable at 10.54% while the underlying profitability remains strong and will enable sustained growth momentum. SBIN is neither planning to raise any equity capital nor looking at any divestment of its subsidiaries. Instead, the bank may raise AT-1 capital to shore up its capital adequacy, and has recently raised INR33b of AT1 bonds and has further proposals in place.

State Bank of India

Mr. Dinesh Kumar Khara
Chairman, SBI

Mr. Khara joined SBIN as a Probationary Officer in CY84 and has over 39 years of rich experience in all facets of banking. He completed his MBA from FMS New Delhi and his M.Com from Delhi School of Economics. He is also a Certified Associate of the Indian Institute of Bankers (CAIIB).

Loan growth momentum remains healthy

Loan growth remains healthy and the bank has guided for mid-teen growth over the medium term while keeping asset quality metrics under control. SBIN expects limited impact on growth due to recent regulations, as the loan book is broad-based. On the unsecured loan book (Xpress credit), growth has already moderated to 18% YoY from 25% earlier. The bank believes that the regulator's concern is more on the quality of loans, and noted that its Xpress credit portfolio has robust underwriting as 96% of salaried customers are government employees. In the Corporate segment, SBIN expects growth momentum to stay healthy as it has a proposal pipeline of INR3.4t, and INR1.4t is pending for disbursements (total lending opportunity of INR4.8t). **The manufacturing, export, renewables, batteries and EV segments are likely to be the key growth drivers.** In the SME segment, SBIN has been able to grow at a healthy rate of 15-20% while improving its GNPA to 3.1% from 7.8% in 1QFY22. SBIN aims to scale up its SME book to >INR4t in the near term as it is trying to improve its penetration in vendor finance and SME financing.

Margins to be range-bound with a slight downward bias

The management has indicated that the cost of deposits has nearly peaked and the bank has not increased TD rates since Feb'23. The limited residual deposit re-pricing is expected to happen in 3QFY24 and will largely be offset by re-pricing of MCLR-linked loans. SBIN does not expect any further increase in deposit rates but believes that rates may remain elevated for long. The bank expects NIMs to be broadly stable with a possibility of a minor 3-5bp contraction. SBIN also expects to improve its LDR, which should support margins. The bank has not changed interest rates on unsecured loans and loans to NBFCs after the recent RBI measures and will be reviewing the same over the coming months.

Nitin Aggarwal - Research Analyst (Nitin.Aggarwal@MotilalOswal.com)
Research Analyst: Dixit Sankharva (Dixit.sankharva@motilaloswal.com) | **Disha Singhal** (Disha Singhal@MotilalOswal.com)

Asset quality remains robust; credit cost to be under control at ~50bp

Asset quality has remained well under control with constant moderations in GNPA/NNPA ratios and overall stress pool. The bank has thus witnessed 97bp/16bp YoY decline in GNPA/NNPA to 2.55%/0.64% in 2QFY24. Slippages have been under control and the management expects the similar trajectory to continue. SME restructured book has come down to 4.4% from 6% in 3QFY23 and the bank further expects this to decline to 3-3.5%, which should keep incremental slippages in check. Overall the bank has guided for controlled credit cost at <50bp. Further, the migration to ECL will have a limited impact of INR50b over the next five years as asset quality has improved significantly.

C/I should moderate to ~50% over 12-18 months; will help to deliver sustainable RoA of ~1.2%

The opex run rate has been high as SBIN made the additional wage hike provisions, reflecting a 14% wage hike from 10% earlier. The bank has thus provided INR39.8b of additional wage provisions in 2Q and expects up to ~INR20b to flow in 3Q/4QFY24 as the wage hike settlement happens at ~15%. SBIN thus expects operating cost growth to moderate in FY25 and has guided for a cost-income ratio of ~50% over the next 12-18 months.

A gradual ramp-up in digital lending via YONO is also resulting in operational efficiencies and will lead to moderation in cost ratios. The bank has surpassed its previous RoA target of 1%, and now aims to deliver 1.2% RoA and ~20% RoE on a sustainable basis.

Other takeaways

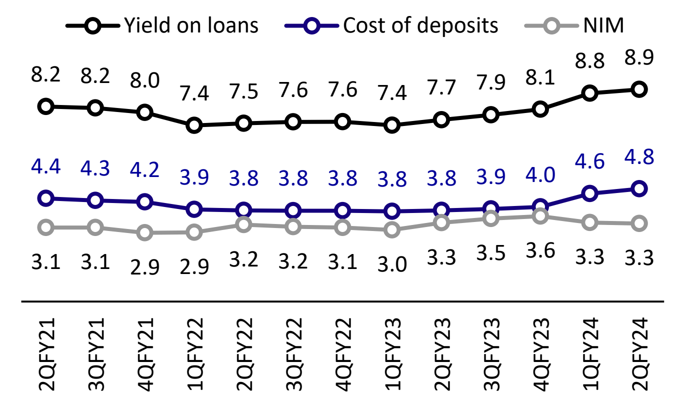
- The RBI is more concerned about unsecured lending by NBFCs and new-age fintechs, rather than banks. SBIN does not expect any more steps from the RBI hereon.
- Overall, the bank's loan book is growing at a good pace, and the increase in Xpress credit rates will not lead to any major impact on growth in unsecured loans.
- About 96% of salaried customers in Xpress credit are govt employees, and the maximum ticket size for personal loans is INR3.5m.
- Power sector investments are more in the renewable sector (mainly solar sector). In solar, the bank has an ample number of proposals, including from households, agri and industrials.
- SBIN does not expect the NPA cycle to be like what was witnessed earlier. Interest rate risk can be converted into credit risk and more so for the entities that have been aggressive in unsecured loans.
- The bank has created a credit review department and as a result, the underwriting process has strengthened significantly. All the credit committees are headed by non-business executives, which brings a lot of objectivity. Over the years, the bank has worked on sourcing, collection and underwriting processes, resulting into better asset quality outcomes.
- For better quality loans, the bank was foregoing the fee income. However, the bank aims to steadily grow its forex income and expects 30% growth.
- In 2QFY24, SBIN earned INR1.9b of fee income via YONO and has built ~INR1t of loan book via YONO in FY23, which it expects to grow 30% YoY in FY24. About 65% of the SA accounts are opened through YONO. Majority of the credit activity on YONO is on the account of PAPL and PABL loans.
- SBIN does not plan to expand its Banca channel partnerships in insurance. There are no plans to review the commission rate that SBIN earns from the sale of its life insurance business.

Valuation and view: RoE to sustain at ~18-19% over FY24-25E; reiterate BUY with a TP of INR700

SBIN's robust performance has been aided by strong loan growth and lower provisions. Opex has been running elevated due to high wage provisions affecting PPoP growth. NIMs have declined in recent quarters and the management has guided for broadly stable margins (3-5bp downside bias) as the bank has levers in place (CD ratio, MCLR re-pricing) to mitigate the impact of the rising cost of deposits. The asset quality performance remains strong with consistent improvements in headline asset quality ratios, while the restructured book remains under control at 0.6%, along with lower SMA pool at 12bp of loans. We estimate SBIN to deliver FY25E RoA/RoE of 1.1%/18.3%. We believe that the bank is well poised to deliver >1% RoA on a sustainable basis. **We reiterate BUY with a TP of INR700 (1.1x FY25E ABV + INR202 from subs). SBIN remains one of our preferred picks in the sector.**

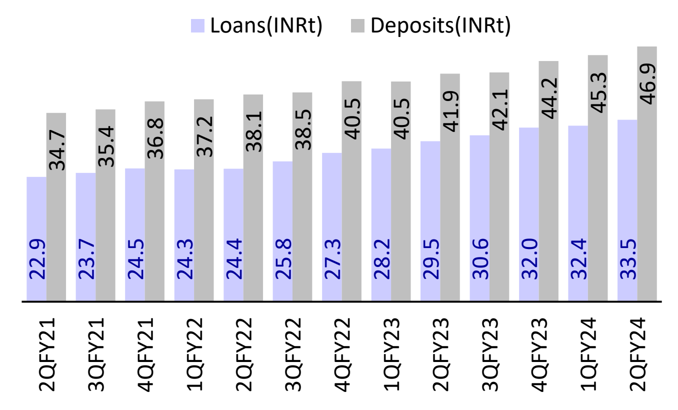
Story in charts

Exhibit 1: NIMs moderated in recent quarters



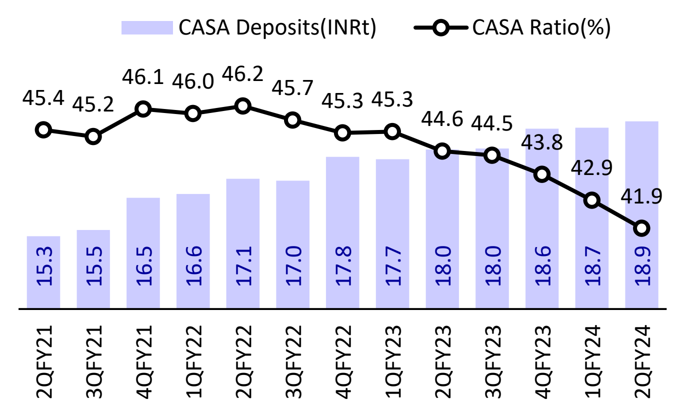
Source: MOFSL, Company

Exhibit 2: Loan/deposit growth healthy at 13%/12% YoY



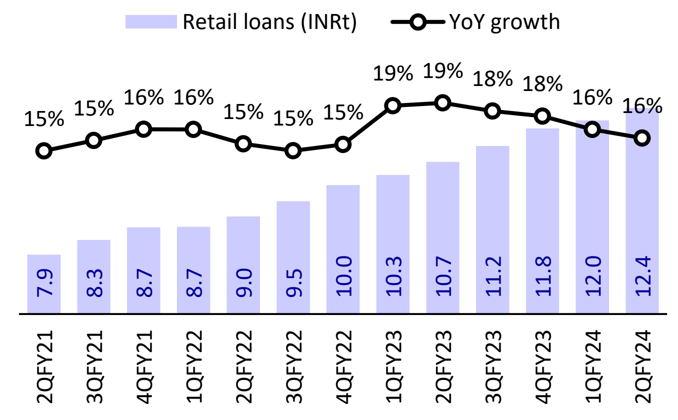
Source: MOFSL, Company

Exhibit 3: CASA ratio moderated to 41.9%



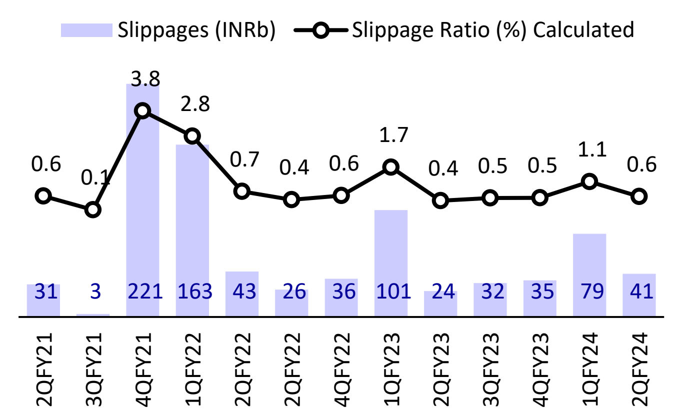
Source: MOFSL, Company

Exhibit 4: Retail loans grew ~15.7% YoY



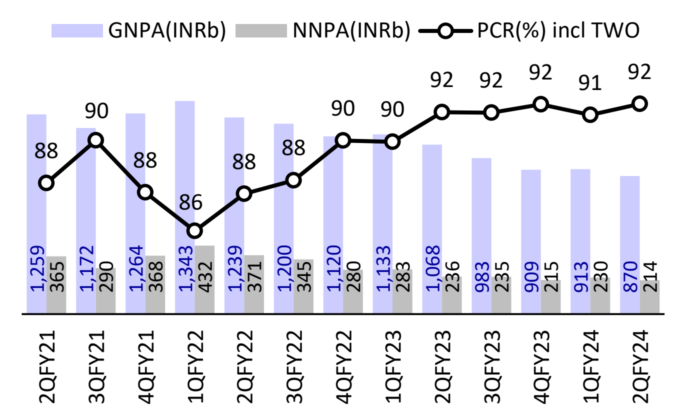
Source: MOFSL, Company

Exhibit 5: Slippages moderated to INR41b (annualized 0.6%)



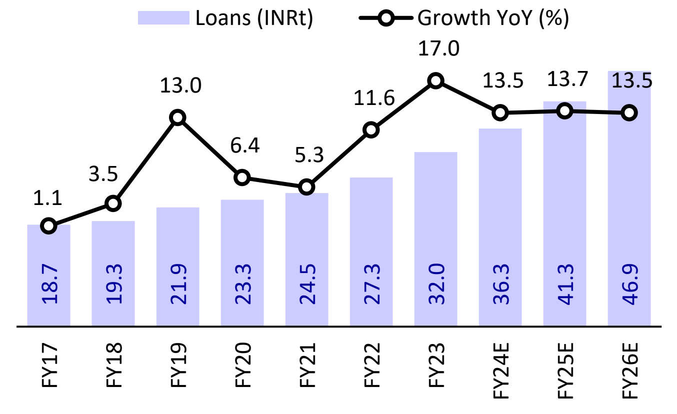
Source: MOFSL, Company

Exhibit 6: GNPA/NNPA improved to 2.55%/0.64%



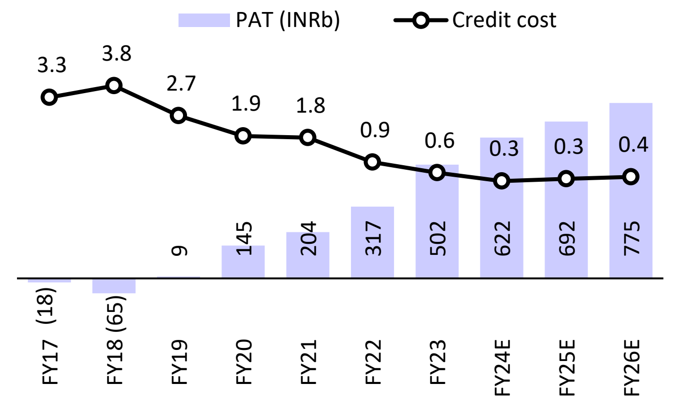
Source: MOFSL, Company

Exhibit 7: Expect 13% CAGR in loans over FY23-25



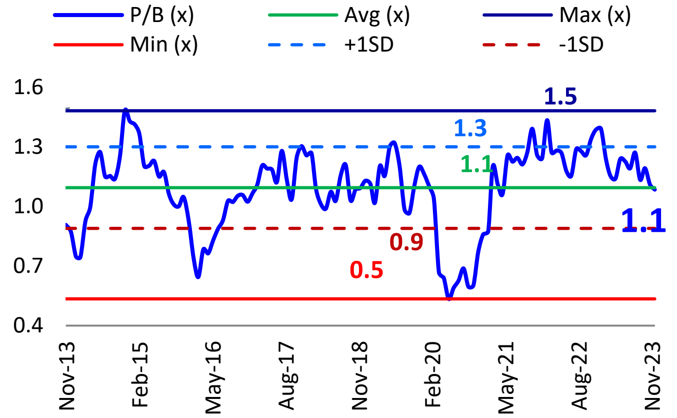
Source: MOFSL, Company

Exhibit 8: Credit cost to remain in control, aiding PAT



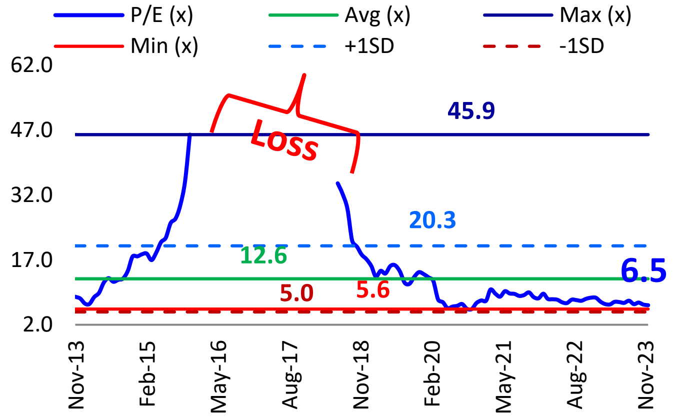
Source: MOFSL, Company

Exhibit 9: Trend in P/B multiple of the bank



Source: MOFSL, Company

Exhibit 10: Trend in P/E multiple of the bank



Source: MOFSL, Company

Financials and valuations

Income Statement								(INRb)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Interest Income	2,428.7	2,573.2	2,651.5	2,754.6	3,321.0	4,314.5	4,747.9	5,216.6
Interest Expense	1,545.2	1,592.4	1,544.4	1,547.5	1,872.6	2,717.2	2,926.6	3,177.3
Net Interest Income	**883.5**	**980.8**	**1,107.1**	**1,207.1**	**1,448.4**	**1,597.2**	**1,821.3**	**2,039.2**
Change (%)	18.0	11.0	12.9	9.0	20.0	10.3	14.0	12.0
Non-Interest Income	**367.7**	**452.2**	**435.0**	**405.6**	**366.2**	**476.0**	**499.8**	**564.8**
Total Income	**1,251.2**	**1,433.1**	**1,542.1**	**1,612.7**	**1,814.6**	**2,073.3**	**2,321.1**	**2,604.0**
Change (%)	4.7	14.5	7.6	4.6	12.5	14.3	12.0	12.2
Operating Expenses	696.9	751.7	826.5	859.8	977.4	1,154.5	1,253.7	1,373.8
Pre Provision Profits	**554.4**	**681.3**	**715.5**	**752.9**	**837.1**	**918.8**	**1,067.5**	**1,230.2**
Change (%)	-6.8	22.9	5.0	5.2	11.2	9.8	16.2	15.2
Core Provision Profits	**522.9**	**595.6**	**655.2**	**720.7**	**850.7**	**935.0**	**1,087.0**	**1,253.6**
Change (%)	13.5	13.9	10.0	10.0	18.0	9.9	16.2	15.3
Provisions (excl tax)	531.3	430.7	440.1	244.5	165.1	86.8	140.4	193.0
Exceptional Items (Exp)	NA	NA	NA	74.2	NA	NA	NA	NA
PBT	**23.1**	**250.6**	**275.4**	**434.2**	**672.1**	**832.0**	**927.0**	**1,037.2**
Tax	14.5	105.7	71.3	117.5	169.7	210.5	234.5	262.4
Tax Rate (%)	62.6	42.2	25.9	27.1	25.3	25.3	25.3	25.3
PAT	**8.6**	**144.9**	**204.1**	**316.8**	**502.3**	**621.5**	**692.5**	**774.8**
Change (%)	-113.2	1,580.3	40.9	55.2	58.6	23.7	11.4	11.9
Cons. PAT post MI	**23.0**	**197.7**	**224.1**	**353.7**	**556.5**	**697.3**	**798.6**	**923.4**
Change (%)	-150.5	759.6	13.3	57.9	57.3	25.3	14.5	15.6

Balance Sheet								
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Share Capital	9	9	9	9	9	9	9	9
Reserves & Surplus	2,200	2,311	2,530	2,792	3,267	3,766	4,327	4,961
Net Worth	**2,209**	**2,320**	**2,539**	**2,801**	**3,276**	**3,774**	**4,336**	**4,970**
Deposits	**29,114**	**32,416**	**36,813**	**40,515**	**44,238**	**48,662**	**53,528**	**59,148**
Change (%)	7.6	11.3	13.6	10.1	9.2	10.0	10.0	10.5
of which CASA Dep	**12,976**	**14,337**	**16,713**	**18,036**	**18,874**	**20,341**	**22,589**	**25,375**
Change (%)	7.8	10.5	16.6	7.9	4.7	7.8	11.1	12.3
Borrowings	4,030	3,147	4,173	4,260	4,931	5,552	6,219	6,982
Other Liab. & Prov.	1,456	1,631	1,820	2,299	2,725	3,079	3,541	4,072
Total Liabilities	**36,809**	**39,514**	**45,344**	**49,876**	**55,170**	**61,067**	**67,624**	**75,171**
Current Assets	2,225	2,511	3,430	3,946	3,079	3,237	3,467	3,731
Investments	**9,670**	**10,470**	**13,517**	**14,814**	**15,704**	**16,803**	**17,912**	**19,219**
Change (%)	-8.9	8.3	29.1	9.6	6.0	7.0	6.6	7.3
Loans	**21,859**	**23,253**	**24,495**	**27,340**	**31,993**	**36,312**	**41,286**	**46,860**
Change (%)	13.0	6.4	5.3	11.6	17.0	13.5	13.7	13.5
Fixed Assets	392	384	384	377	424	458	494	534
Other Assets	2,663	2,896	3,518	3,399	3,971	4,257	4,464	4,827
Total Assets	**36,809**	**39,514**	**45,344**	**49,876**	**55,170**	**61,067**	**67,624**	**75,171**

Asset Quality								
GNPA	1,728	1,491	1,264	1,120	909	798	812	884
NNPA	659	519	368	282	217	184	181	186
GNPA Ratio	7.53	6.15	4.98	3.98	2.78	2.2	1.9	1.9
NNPA Ratio	3.01	2.23	1.50	1.03	0.68	0.5	0.4	0.4
Slippage Ratio	1.6	2.2	1.2	1.0	0.6	0.7	0.9	0.9
Credit Cost	2.7	1.9	1.8	0.9	0.6	0.3	0.3	0.4
PCR (Excl Tech. W/O)	61.9	65.2	70.9	74.9	76.2	77.0	77.8	79.0

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Yield and Cost Ratios (%)								
Avg. Yield-Earning Assets	**7.8**	**7.7**	**7.2**	**6.7**	**7.2**	**8.5**	**8.4**	**8.2**
Avg. Yield on loans	7.8	8.0	7.2	6.6	7.5	8.9	8.7	8.6
Avg. Yield on Investments	7.5	6.9	6.8	6.1	6.4	7.0	7.1	7.0
Avg. Cost-Int. Bear. Liab.	**4.8**	**4.6**	**4.0**	**3.6**	**4.0**	**5.3**	**5.1**	**5.0**
Avg. Cost of Deposits	5.0	4.8	4.1	3.7	3.8	5.0	4.9	4.8
Interest Spread	**2.9**	**3.1**	**3.1**	**3.0**	**3.2**	**3.2**	**3.2**	**3.2**
Net Interest Margin	**2.8**	**3.0**	**3.0**	**2.9**	**3.2**	**3.1**	**3.2**	**3.2**
Capitalization Ratios (%)								
CAR	12.8	13.3	14.0	13.8	14.7	14.9	15.3	15.7
Tier I	*10.8*	*11.2*	*11.7*	*11.4*	*12.1*	*12.2*	*12.9*	*13.5*
Tier II	*2.1*	*2.1*	*2.3*	*2.4*	*2.6*	*2.7*	*2.4*	*2.2*
Business and Efficiency Ratios (%)								
Loans/Deposit Ratio	75.1	71.7	66.5	67.5	72.3	74.6	77.1	79.2
CASA Ratio	44.6	44.2	45.4	44.5	42.7	41.8	42.2	42.9
Cost/Assets	1.9	1.9	1.8	1.7	1.8	1.9	1.9	1.8
Cost/Total Income	55.7	52.5	53.6	53.3	53.9	55.7	54.0	52.8
Cost/Core Income	57.1	55.8	55.8	54.4	53.5	55.3	53.6	52.3
Int. Expense./Int. Income	63.6	61.9	58.2	56.2	56.4	63.0	61.6	60.9
Fee Income/Total Income	26.9	25.6	24.3	23.2	20.9	23.7	22.4	22.6
Non Int. Inc./Total Income	29.4	31.6	28.2	25.2	20.2	23.0	21.5	21.7
Empl. Cost/Total Expense	58.9	60.8	61.6	58.3	58.6	60.0	59.7	59.4
Investment/Deposit Ratio	33.2	32.3	36.7	36.6	35.5	34.5	33.5	32.5
Profitability Ratios and Valuation								
RoE	0.4	7.2	9.3	13.0	18.1	19.1	18.3	17.7
RoA	0.0	0.4	0.5	0.7	1.0	1.1	1.1	1.1
RoRWA	0.0	0.7	0.9	1.2	1.7	1.9	1.9	1.9
Consolidated RoE	1.0	7.9	8.2	11.8	16.2	17.5	17.2	16.9
Consolidated RoA	0.1	0.5	0.5	0.7	1.0	1.1	1.1	1.2
Book Value (INR)	232	245	270	299	350	406	469	540
Change (%)	0.9	5.6	10.0	10.9	16.9	16.0	15.5	15.1
Price-BV (x)	**1.6**	**1.5**	**1.4**	**1.2**	**1.0**	**0.9**	**0.8**	**0.7**
Consol BV (INR)	248	267	294	328	385	460	545	644
Change (%)	2.0	7.7	10.3	11.5	17.4	19.4	18.6	18.2
Price-Consol BV (x)	**2.3**	**2.1**	**1.9**	**1.7**	**1.5**	**1.2**	**1.0**	**0.9**
Adjusted BV (INR)	170	187	221	256	311	370	435	506
Price-ABV (x)	**2.2**	**2.0**	**1.7**	**1.4**	**1.2**	**1.0**	**0.8**	**0.7**
Adjusted Consol BV	192	212	250	289	350	426	511	610
Price-Consol ABV (x)	**3.0**	**2.7**	**2.3**	**2.0**	**1.6**	**1.3**	**1.1**	**0.9**
EPS (INR)	1.0	16.2	22.9	35.5	56.3	69.6	77.6	86.8
Change (%)	-112.6	1,580.3	40.9	55.2	58.6	23.7	11.4	11.9
Price-Earnings (x)	**379.0**	**22.6**	**16.0**	**10.3**	**6.5**	**5.3**	**4.7**	**4.2**
Consol EPS (INR)	2.6	22.1	25.1	39.6	62.4	78.1	89.5	103.5
Change (%)	-148.2	759.6	13.3	57.9	57.3	25.3	14.5	15.6
Price-Consol EPS (x)	**220.6**	**25.7**	**22.6**	**14.3**	**9.1**	**7.3**	**6.4**	**5.5**
Dividend Per Share (INR)	0.0	0.0	4.0	7.1	11.3	13.8	14.6	15.8
Dividend Yield (%)	**0.0**	**0.0**	**0.7**	**1.2**	**2.0**	**2.4**	**2.6**	**2.8**

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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Grievance Redressal Cell:

Contact Person	Contact No.	Email ID
Ms. Hemangi Date	022 40548000 / 022 67490600	query@motilaloswal.com
Ms. Kumud Upadhyay	022 40548082	servicehead@motilaloswal.com
Mr. Ajay Menon	022 40548083	am@motilaloswal.com

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