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INDIA RESEARCH

Dena Bank

Rs35
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs10.0bn; US$205mn

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Result: Q3FY09
Comment: Strong NII buoys robust earnings growth
Revision: Upgrading estimates by 8% for FY09 and 4% for FY10
Last report: 23 October 2008 (Price Rs33; Recommendation: Outperformer)

Key valuation metrics

Year to 31 March (Rs mn)	2006	2007	2008	2009E	2010E
Net profit (Rs mn)	730	2,016	3,598	4,184	4,365
yoy growth (%)	*19.7*	*176.2*	*78.5*	*16.3*	*4.3*
Shares in issue (mn)	287	287	287	287	287
EPS (Rs)	2.5	7.0	12.5	14.6	15.2
EPS growth (%)	19.7	176.1	78.5	16.3	4.3
PE (x)	13.8	5.0	2.8	2.4	2.3
Book value (Rs/share)	37.2	43.2	54.6	69.6	85.2
Adj. Book value (Rs/share)	32.0	38.3	53.1	70.3	89.9
P/ Adj. Book (x)	1.10	0.91	0.66	0.50	0.39
RoAE (%)	6.4	14.2	21.8	20.8	17.9

Dena Bank reported PAT of Rs1.4bn, 39% yoy growth (ahead of expectations) driven by robust NII performance and strong treasury gains. NII came in at Rs3.5bn, stellar growth of 71% yoy, bolstered by Rs322mn of interest on income tax refund received during the quarter. Net of tax refund, NII grew by 56% yoy, buoyed by (i) 90bps qoq expansion in margins; and (ii) healthy credit growth of 21% yoy. Elevated term deposits led to a steep ~170bp qoq decline in CASA to 38.9%. Bottom-line growth was bolstered by 16% yoy growth in non-fund income, driven by strong treasury gains and 34% yoy growth in forex income. Operating expenses grew by 35% yoy as the bank made wage hike provision of Rs300mn and higher AS-15 provisions during the quarter. Provision expenses were in line, supported by write-backs of investment depreciation provisions. Despite stress in operating environment Gross NPAs as well as Net NPAs remained stable sequentially, while coverage deteriorated by ~170bps qoq to 54.6% in Q3FY09. The bank is set to benefit from Government's stance of recapitalizing PSU banks as its CRAR stands at 11.79% (Tier-I at 6.99%) and it will need capital over the next few months to sustain growth. To factor in momentum in NII and higher treasury gains, though partly offset by higher expenses, we are upgrading our estimates by 8% for FY09, and 4% for FY10. We expect 10% CAGR in the bank's profit over FY08-10, with an average ROE of 19%. The stock is currently trading at attractive valuations of 0.50x FY09 and 0.39x FY10 book. Maintain Outperformer with a price target of Rs65.

KEY HIGHLIGHTS

❑ Strong bottom-line performance…

Dena Bank reported PAT of Rs1.4bn in Q3FY09, 39% yoy growth, ahead of our estimates. Bottom-line has been buttressed by traction in NII and higher treasury gains. However, the bank paid higher tax of Rs786mn for Q3FY09 (Rs305mn in Q3FY08), implying an effective tax rate of 36% as against 23% in Q3FY08. Higher tax rate is attributable to higher income during the quarter as a result of which the bank is moving from MAT to full tax. Going forward, the management expects the bank to remain under full tax rate.

❑ …driven by traction in NII…

The bank reported a stellar NII growth of 71% yoy to Rs3.5bn, higher than our estimate of Rs2.6bn, as the bank received Rs322mn of interest on income tax refund during the quarter. Net of tax refund, NII has still grown by a robust 56% yoy to Rs3.2bn. The outperformance is driven by expansion in margins, enhancement in CD ratio and healthy 21% yoy growth in advances. In Q3FY09, growth in advances has outpaced the deposits leading to an improvement in CD ratio by 170bps qoq to 70.2%, with incremental CD ratio of 143% over the quarter.

Strong growth in volumes – CD ratio improves

(Rs mn)	Q3FY08	Q2FY09	Q3FY09	Incremental in Q3	yoy growth (%)	qoq growth (%)
Advances	212,550	244,913	256,862	11,949	20.8	4.9
Deposits	308,390	357,769	366,108	8,339	18.7	2.3
Investments	98,528	111,918	119,790	7,872	21.6	7.0
CD ratio (%)	68.92	68.46	70.16	143bps	124bps	170

Source: Company, IDFC-SSKI Research

❑ …as margins expand

In Q3FY09, Dena Bank reported NIMs of 3.76%, an expansion of ~90bps qoq, driven by 70bp sequential expansion in loan yields, further bolstered by interest on tax refund during the quarter. Excluding the impact of tax refund, calculated margins expanded by 55bp sequentially to 3.1% on the back of CRR/SLR unwind and elevated lending rates in Q3FY09. Despite the elevated borrowing rates during the quarter, rise in cost of deposits has been restricted to merely 7bp qoq as the bank has re-priced the bulk deposits at lower rates.

Subsequent to aggressive monetary easing by RBI over Q3FY09, Dena Bank reduced its PLR by aggregate 150bps in two tranches (75bps effective mid Nov'08 and 75bps effective Jan'09), and full impact of re-pricing will be seen in Q4FY09. Consequently, going forward we expect margins to compress as deposits re-price with a lag and lower credit demand exerts pressure on CD ratio. In such a scenario, deterioration in CASA will add to the bank's woes.

Movement of yields and cost of deposits

(%)	Q3FY08	Q2FY09	Q3FY09	yoy change (bps)	qoq change (bps)
Reported					
Yield on advances	10.21	10.80	11.47	126	67
Yield on investments	8.43	6.87	8.96	53	209
Blended Yields	8.36	8.70	9.79	143	109
Cost of deposits	5.83	6.32	6.39	56	7
NIM (%)	2.33	2.88	3.76	143	88
Calculated					
Yield on advances	9.70	10.43	11.25	154.7	82.6
Yield on investments	2.14	2.03	2.07	(7.0)	4.0
Blended Yields	8.11	8.23	8.91	80.1	67.9
Cost of deposits	5.08	6.20	6.45	137.6	25.5
Spreads	3.03	2.03	2.46	(57.5)	42.4
NIM (%)	2.48	2.54	3.42	93.6	87.4

Source: Company, SSKI Research; ratios calculated by us on quarterly average balances

❑ Steady growth in advances - driven by corporate loans

Steady growth in volumes continued as Dena bank's advances grew by 21% yoy to Rs245bn. The growth was primarily driven by corporate loans which continue to grow at a robust ~50% yoy during the quarter.

Composition of loan book

(Rs bn)	Q3FY08	Q2FY09	Q3FY09	yoy growth (%)	% of total advances
Direct Retail	26.7	30.8	32.6	21.8	12.7
Agriculture credit	26.4	31.9	35.9	35.9	14.0
SME Credit	35.6	39.6	41.0	15.0	15.9
Others	97.3	142.5	147.5	51.6	57.4
Total advances	**212.6**	**244.9**	**256.9**	**20.8**	**100.0**

Source: Company

❑ Robust non-interest income- supported by strong trading gains

In Q3FY09 Dena Bank reported robust non-fund income of Rs1.4bn – a growth of 8.2% yoy, higher than our estimates. The outperformance is attributable to trading gains of Rs4.9bn during the quarter as against losses in H1FY09, in context of volatility in capital markets. However, the non-trading income de-grew marginally by 1.3% yoy on the back of lower recoveries. Within fee income, CEB grew at a subdued pace of 7% yoy, while forex exhibited strength with a growth of 34% yoy. Recoveries came in lower at Rs290mn as against Rs370mn in Q3FY08, reflecting the current challenging credit environment.

Other Income Break-up

(Rs mn)	Q3FY08	Q2FY09	Q3FY09	Yoy growth (%)	qoq growth (%)
Trading profits	378	(69)	494	30.6	NM
Non-trading other income	897	921	885	(1.3)	(3.9)
CEB	283	356	303	7.0	(14.9)
Forex income	89	127	120	34.0	(6.0)
Recovery in written off acc	370	210	290	(21.7)	37.9
Total Other Income	**1,275**	**852**	**1,379**	**8.2**	**61.9**

Source: Company; NM= Not Meaningful

❑ Operating expenses – providing for wage hike

In Q3FY09, Dena Bank's operating expenses have grown by 35% yoy to Rs2.3bn, higher than our estimates, driven by higher employee expenses. Employee expenses increased by 50% yoy on the back of (i) wage hike provision of Rs300mn made in Q3FY09; and (ii) higher AS-15 provisions by Rs80-90mn during the quarter, as a steep decline in G-sec yields has led to an increase in NPV of pension liabilities of the bank. The bank has assumed a wage hike of ~15% and has estimated the liability to amount to ~Rs600mn, and intends to provide for balance ~Rs100mn over the next quarter.

❑ Provision expenses in-line

Provision expenses came in at Rs462mn in Q3FY09, inline with expectations. These were higher against Rs351mn in Q3FY08 (Rs373mn in Q2FY09), due to higher NPA provisions of Rs669mn during the quarter. The provisions were supported by write-back of Rs397mn of excess investment depreciation on the back of steep decline in G-sec yields over the quarter. The bank also made a provision of Rs190mn against an old LC account, which was under dispute and has now been settled in court against Dena Bank.

Break-up of Provisions

(Rs mn)	Q3FY08	Q2FY09	Q3FY09	yoy change (%)
NPA	360	265	669	86
Depreciation	(34)	(21)	(397)	1056
Provision for std assets/ restructured assets	119	129	-	-
Other Provisions	7	(0)	190	NM
Total provisions	**351**	**373**	**462**	**32**

Source: Company; NM= Not meaningful

❑ Stable asset quality

Asset quality remained largely stable as Gross NPAs declined marginally to 2.28% from 2.32% in Q2FY09. In Q3FY09, Net NPA ratio came in at 1.05% as against 1.02% in Q2FY09. However, provision coverage has declined on a sequential (as well as yoy) basis to 54.6% in Q3FY09 from 56.3% in Q2FY09. Also, there is an increase in slippages to Rs1.4bn in Q3FY09 as against Rs816mn in Q3FY08.

Asset quality remains stable

	Q3FY08	Q2FY09	Q3FY09	YoY change (%)	QoQ change (%)
Gross NPAs (Rs mn)	6,570	5,684	5,855	(10.9)	3.0
Gross NPAs (%)	3.09	2.32	2.28	(81bps)	(4bps)
Net NPAs (Rs mn)	2,938	2,483	2,656	(9.6)	7.0
Net NPAs (%)	1.41	1.02	1.05	(36bps)	3bps
Slippages	816	1,331	1,426	74.7	7.2
Slippages/avg. advances (%)	0.40	0.56	0.57	17bps	1bp
Coverage (%)	55.29	56.32	54.64	(65bps)	(168bps)

Source: Company

❑ Capital adequacy – limited head room for Tier-I

As of Q3FY09, Dena Bank's Tier-I capital adequacy ratio stood at 6.99% (as against 7.12% in Q2FY09). At the same time, overall CAR decreased to 11.79% from 12.34% in Q2FY09. Given the Government holding of 51.2%, Dena Bank has limited headroom to raise capital (management indicated headroom of Rs8bn by raising bonds). The management has indicated that current levels of capital are adequate to sustain growth in FY09, after which it might need to raise further capital and is already in discussion with the government to do so.

❑ Revising estimates, Maintain Outperformer

Dena Bank reported PAT of Rs1.4bn, 39% yoy growth (ahead of expectations) driven by robust NII performance and strong treasury gains. To factor in momentum in NII and higher treasury gains, though partly offset by higher expenses, we are revising our estimates by 8% for FY09, and 4% for FY10. We expect 10% CAGR in the bank's profit over FY08-10, with an average ROE of 19%. The stock is currently trading at attractive valuations of 0.50x FY09 and 0.39x FY10 book. Maintain Outperformer with a price target of Rs65.

Earnings model

Rs mn	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	FY07	FY08	FY09E	FY10E
Interest income	**6,766**	**7,392**	**7,675**	**8,286**	**9,556**	**21,185**	**27,101**	**34,580**	**38,571**
Interest expenses	4,707	5,010	5,487	5,744	6,032	12,632	18,171	23,267	25,973
Net interest income	2,059	2,383	2,188	2,543	3,525	8,554	8,929	11,313	12,599
yoy growth (%)	*(1.9)*	*2.3*	*0.9*	*23.0*	*71.2*	*18.4*	*4.4*	*26.7*	*11.4*
Net revenue	**3,334**	**3,820**	**2,857**	**3,395**	**4,904**	**12,469**	**13,369**	**15,817**	**17,257**
Non fund income	1,275	1,437	669	852	1,379	3,915	4,440	4,503	4,658
Trading profits	378	387	(102)	(69)	494	395	1,200	750	550
Non-trading other income	897	1,051	772	921	885	3,499	3,218	3,753	4,108
Operating expenses	1,667	1,631	1,616	1,903	2,251	6,115	6,504	7,751	8,190
Operating profit	**1,667**	**2,189**	**1,241**	**1,492**	**2,652**	**6,354**	**6,864**	**8,066**	**9,067**
Provisions	351	2,363	500	373	462	4,024	3,679	2,487	3,324
PBT	**1,315**	**(173)**	**741**	**1,119**	**2,190**	**2,330**	**3,185**	**5,579**	**5,743**
Tax	305	(1,283)	58	91	786	315	(413)	1,395	1,378
PAT	**1,011**	**1,110**	**683**	**1,028**	**1,404**	**2,016**	**3,598**	**4,184**	**4,365**
yoy growth (%)	*43.3*	*153.4*	*22.9*	*11.6*	*38.9*	*176.2*	*78.5*	*16.3*	*4.3*
Ratios (%)									
NIM	2.5	2.6	2.2	2.5	3.4	2.9	2.5	2.7	2.6
Other income/Avg assets	1.5	1.6	0.7	0.9	1.3	1.3	1.3	1.1	1.0
Non trading other income /avg assets	1.1	1.2	0.8	0.9	0.9	1.2	0.9	0.9	0.9
Trading income / pre provision profit	22.7	17.7	(8.2)	(4.6)	18.6	6.2	17.5	9.3	6.1
Operating exp/avg assets	2.0	1.8	1.7	1.9	2.2	2.1	1.9	1.9	1.7
Cost/Net rev.	50.0	42.7	56.6	56.0	45.9	49.0	48.7	49.0	47.5
Prov/avg assets	0.4	2.6	0.5	0.4	0.4	1.4	1.0	0.6	0.7
PBT/Avg asets	1.6	(0.2)	0.8	1.1	2.1	0.8	0.9	1.3	1.2
RoA	1.2	1.2	0.7	1.0	1.4	0.7	1.0	1.0	0.9
Tax/PBT	23.2	740.1	7.8	8.1	35.9	13.5	(12.9)	25.0	24.0

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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