SSKI

INDIA RESEARCH

17 November 2006

BSE Sensex: 13429

Dena Bank

Rs33.1

UNRATED

Visit Note

Mkt Cap: Rs9.5bn; US$211m

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We recently met Dena Bank management and came back convinced that the bank would achieve turn around in its fortunes. The legacy asset quality problems are a thing of the past and the bank is well poised to double its earnings this year on the back of steady NII growth, a significant decline in provisioning and increased recoveries. Over the past few years, Dena Bank had to deal with sharp increase in NPAs. Pressure on asset quality arose from the economic downturn of mid 1990s as well as absence of proper internal credit appraisal and control procedures, which led to the bank taking large corporate exposures disproportionate to its size. However, with robust economic growth in the last three years and concerted efforts by the management to improve its asset quality, NPAs are no longer such a grave concern. In fact, recoveries from these bad loans of yesteryears would help the bank in improving its overall profitability in the coming period. If asset quality was a weakness of the bank, its liability profile has always been quite healthy characterized by high CASA ratio (43%) and large proportion of retail deposits coming from its rural and semi-urban branch network. We believe that combination of higher low cost deposits, moderate loan growth and improved loan pricing in the overall industry would help Dena Bank maintain its NIMs. We expect the bank's profits to more than double in the current fiscal driven by lower NPA and depreciation provisions. However, low capital adequacy of the bank (which can be bolstered to some extent by hybrid Tier I bonds) and the fact that its Government holding is down to 51% may restrict long-term growth to as much as its internal accruals permit.

Key financials

Year to 31 March	2003	2004	2005	2006	2007E
Net profit (Rs mn)	1,142	2,305	610	730	1,510
yoy growth	-	101.9	(73.5)	19.7	106.9
Shares in issue (mn)	207	207	287	287	287
EPS (Rs)	5.5	11.1	2.1	2.5	5.3
EPS growth (%)	905.2	101.9	(80.9)	19.7	106.9
PE (x)	6.0	3.0	15.5	13.0	6.3
Book value (Rs/share)	24.7	34.6	34.6	37.2	42.9
Adj. Book value (Rs/share)	0.0	13.4	26.0	32.0	39.0
P/ Adj. Book (x)	N.A.	2.5	1.3	1.0	0.8
RoAE (%)	18.8	31.1	6.3	6.4	10.7

❑ Dena Bank - an introduction

Dena Bank is a mid-sized state owned Indian bank with balance sheet size of Rs283bn as on Sep-2006. The bank has a network of 1,123 branches and 255 ATMs. Its advances portfolio stood at Rs164bn and outstanding deposits were Rs252bn as on September 2006. Government holding in Dena Bank stands at 51.2%.

❑ Dena Bank has a history of higher NPAs

Dena Bank was a reasonably well run bank till late 1990s. However, its problems started from fiscal year 2000, when the bank witnessed the first instance of a sharp increase in non-performing loans. The NPA blowout was a combination of external as well as internal factors:

a) Overall economic downturn: After healthy economic growth momentum in mid 1990s, the Indian economy and particularly manufacturing sector witnessed a material slowdown towards the late 1990s. Many sectors such as steel, cement, power, petrochemicals, etc had witnessed an increase in capacity, which was not globally competitive. Coupled with high leverage and high nominal interest rates, many of the units found it difficult to service the debt. As a result, overall banking system witnessed a steep increase in non-performing loans.

Exhibit 1: Manufacturing and overall GDP growth rate

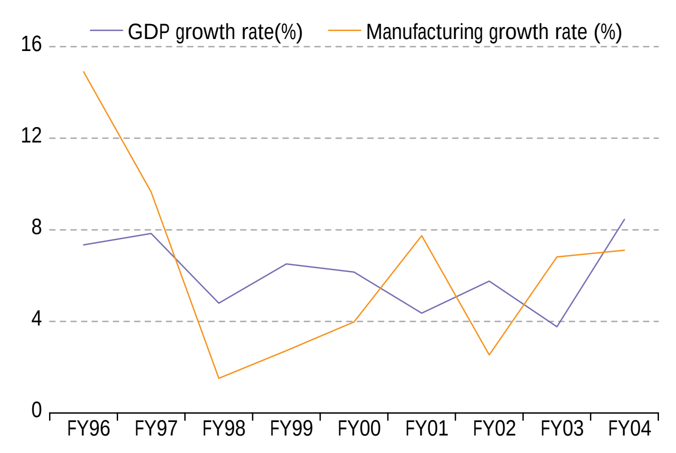
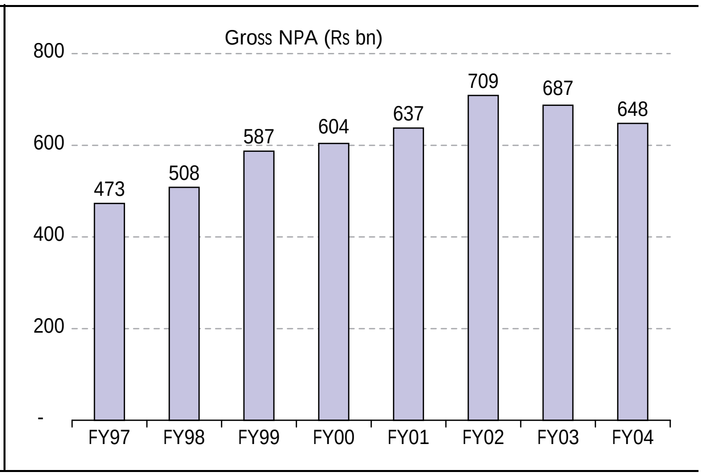


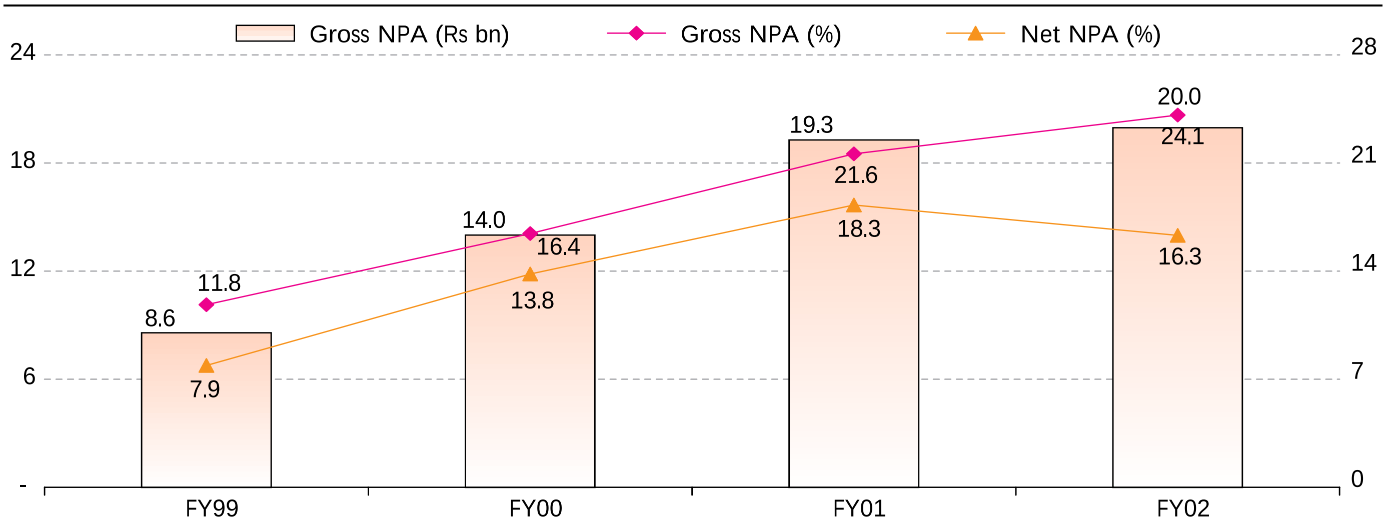
Exhibit 2: Gross NPAs of banking system



Source: Reserve Bank of India

b) Absence of proper control systems: Dena Bank in mid 90s had taken many large corporate exposures, which in the hindsight appear to be disproportionate to the size of the bank at that point of time. These large credit exposures were to several sectors such as steel, petrochemical, power etc, which subsequently ran into rough weather. As a result, Dena Bank's gross NPAs increased by more than 100% between 1999 and 2001.

Exhibit 3: Dena Bank NPA movement



Source: Company, SSKI Research

❑ Bank is making concerted effort to tackle NPA problems

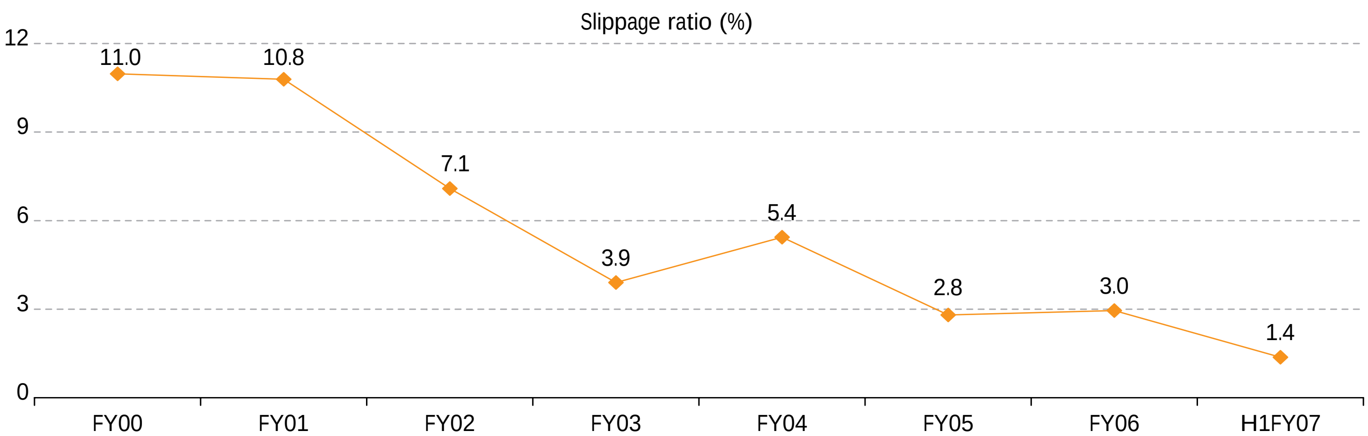
Over the past few years, NPA position of Dena Bank has substantially improved. The bank has adopted a multipronged strategy to tackle its legacy NPA problems. On the one hand, it is taking adequate care to ensure that fresh slippages are minimal. On the other, the bank is aggressively reducing its gross NPAs by a combination of recoveries / settlements / upgradation and write-offs.

a) Controlling fresh slippages: The bank has taken several initiatives to control fresh slippages. As a broader strategy, it is focusing more on retail, agriculture and SME loans rather than going for big ticket corporate loans, where any one account going bad can have a significant impact on NPA profile of the bank. Some of the initiatives taken by the bank to control slippages are:

- Centralized processing of retail loans: The bank is in the process of establishing central processing centers for processing / sanctioning retail loan applications. These centers are expected to help the bank in exercising better control while sanctioning retail loans.
- Collaboration with SMERA: Dena Bank has tied up with SME Rating Agency (SMERA) - set up by SIDBI in collaboration with other PSU banks - to identify credit-worthy and viable SME loan proposals.
- Vigilant monitoring of existing accounts: The bank has realized that fresh slippage in earlier years neutralized its efforts in NPA reduction. To prevent a repeat of this situation, it has attached a very high level of importance to monitoring of existing accounts. The bank has set up an internal committee - Central Slippage Prevention Committee - headed by a General Manager level functionary to rigorously monitor borderline cases. Internally, all the large accounts with any signs of irregularities are monitored on a fortnightly basis.

Results of these efforts in containing fresh slippages are quite visible with slippage ratio sharply falling over the last two years.

Exhibit 4: Improving slippage ratio

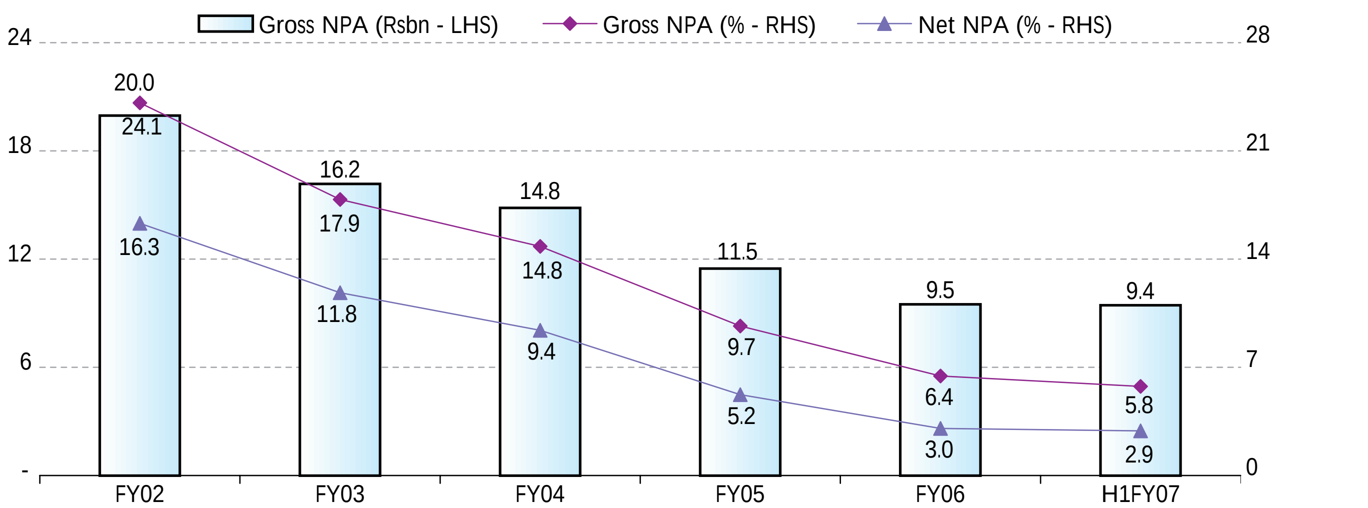


Source: Company, SSKI Research

b) Reduce gross NPAs: Dena Bank has been able to reduce its NPAs substantially by a combination of recoveries, one time settlements, up gradations and write-offs. Its gross NPAs from the peak of Rs19.96bn as on March-2002 have reduced to Rs9.44bn as on Sep-06 while net NPAs have declined from the peak of Rs12.8bn as on March-2001 to Rs4.6bn as on Sep-06. Provision coverage ratio stands at 51.3% as on Sep-06. However, if one includes written off accounts worth Rs14bn, the coverage ratio (including write offs) is quite healthy at ~80%.

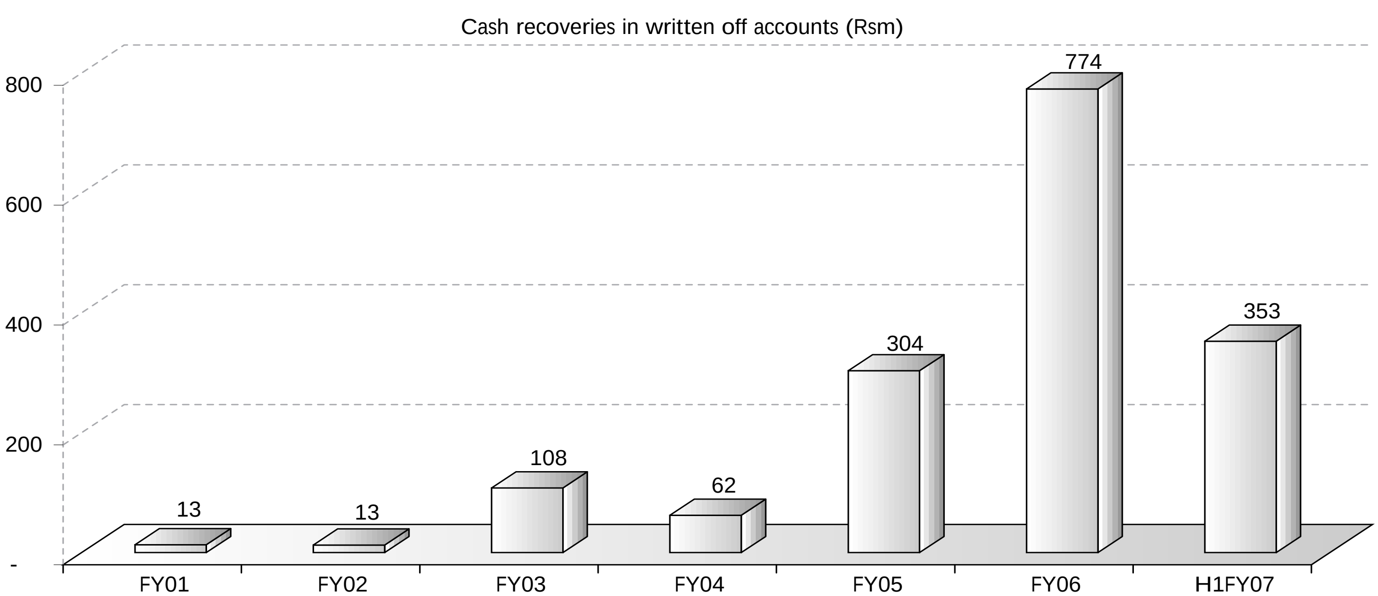
Recoveries: Dena Bank has witnessed higher recoveries in the recent years. This has been due to external factors like buoyant economic conditions and enactment of Securitization Act as also internal efforts including deploying additional and senior level employees towards recoveries and going for quick one time settlements where the bank felt that legal action would be a long drawn process.

Exhibit 5: Improving asset quality



Source: Company, SSKI Research

Exhibit 6: Increasing cash recoveries



Source: Company

❑ Dena Bank has good liability profile

Unlike the problems on the asset side, the liability side of Dena Bank is quite healthy. Its low cost deposits (CASA) ratio in excess of 43% ranks among the highest in PSU banks. Due to modest overall growth in deposits in fiscal 2006 (13% yoy), the bank was able to reduce its cost of deposits in fiscal 2006. Though deposit costs have started moving up in the current fiscal, the bank's ability to maintain high CASA ratio is expected to help it restrict the increase in cost of deposits.

Exhibit 7: improving CASA ratio

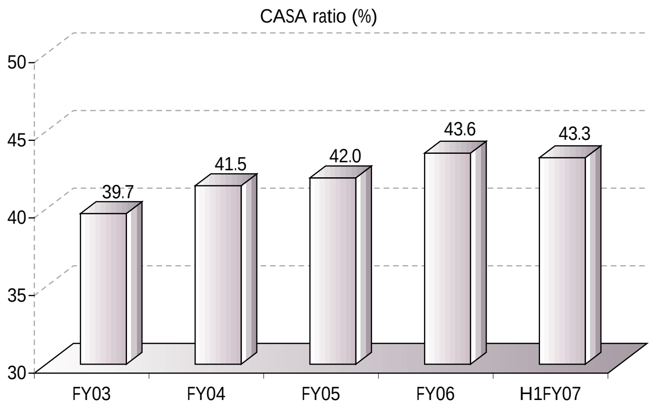
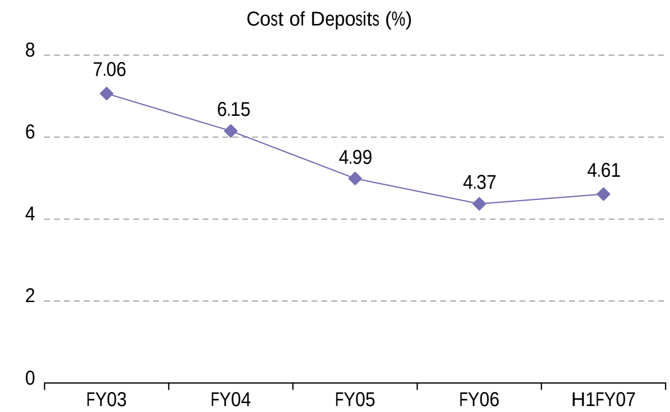


Exhibit 8: Cost of Deposits



Source: Company, SSKI Research

❑ Branch network concentrated in rural and semi-urban areas

Dena Bank has about 1122 branches as on March-2006. Out of these, almost 60% of the branches are situated in rural and semi-urban areas, which help the bank in mobilizing low cost deposits. In terms of geographical presence, more than 60% of Dena Bank's branches are located in the states of Gujarat and Maharashtra.

Exhibit 9: Geographical break-up of branches

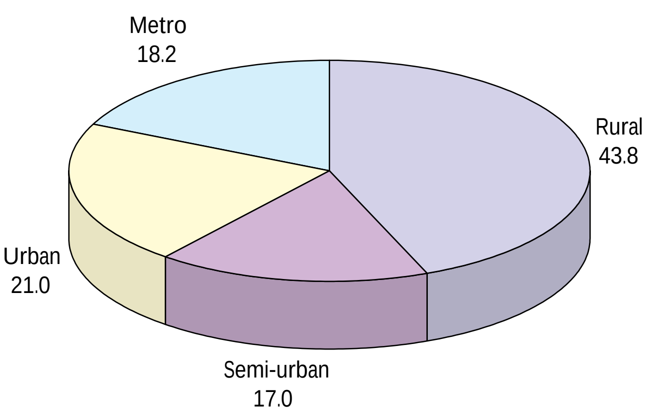


Exhibit 10: state wise branch network

State	No of branches	% of total
Andhra Pradesh	18	1.6
Chattisgarh	66	5.9
Delhi	28	2.5
Goa	16	1.4
Gujarat	475	42.3
Haryana	10	0.9
Karnataka	27	2.4
Kerala	11	1.0
Madhya Pradesh	32	2.9
Maharashtra	235	20.9
Punjab	10	0.9
Rajasthan	16	1.4
Tamilnadu	22	2.0
Uttar Pradesh	43	3.8
West Bengal	27	2.4
Others	86	7.7
Total	1,122	

Source: Company, RBI

❑ Operating efficiency of Dena Bank in line with peer group

Dena Bank has about 10,200 employees comprising approximately 33% officers, 41% clerical staff and remaining subordinate staff. Its operating efficiency - measured in terms of operating expenses as percentage of average assets and employee expenses as percentage of average assets - is broadly in line with other PSU banks.

Exhibit 11: Employee expenses - peer group comparison

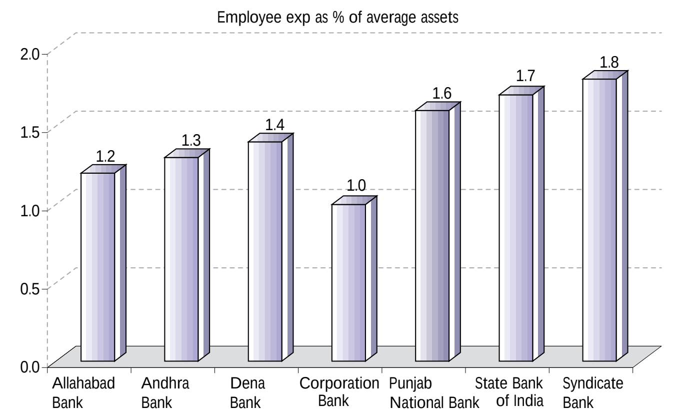
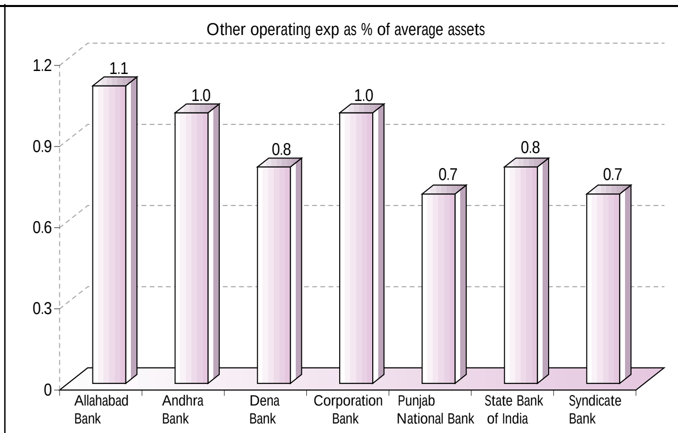


Exhibit 12: Other Opex - peer group comparison

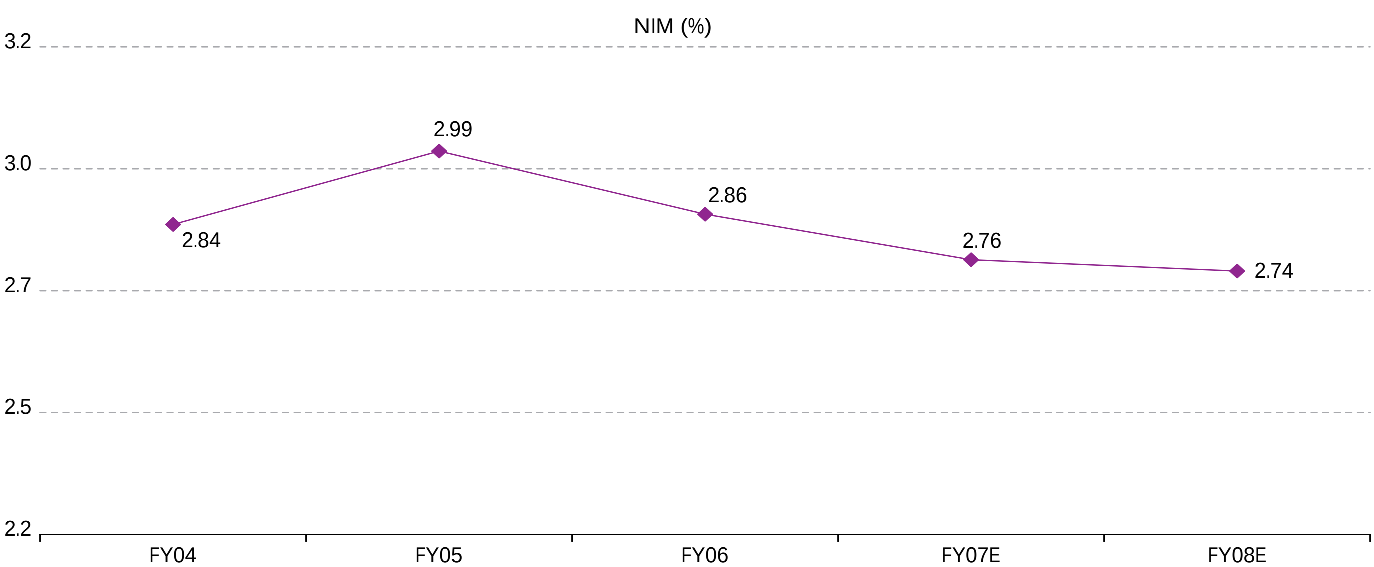


Source: SSKI Research

❑ Margins likely to remain stable going forward

As mentioned earlier, Dena Bank has a healthy depositor profile with 43% CASA ratio, which helps the bank in containing its cost of funds. Besides, the bank has also raised its benchmark prime lending rate (PLR) by 75 bps in two tranches in May-06 and August-06. As a result, its lending yields are likely to improve in current FY (yields already improved by more than 50 bps yoy in first six months of current FY). Therefore, we expect Dena Bank's net interest margin to remain stable at around 2.8%.

Exhibit 13: Dena Bank's NIM movement



Source: SSKI Research

❑ Lower provisioning would be a huge kicker for profitability this year

Dena Bank has heavily provided for its NPAs over past five years. The bank made provisions and write-offs of over Rs14bn over the past five years. As coverage on existing NPAs improves and fresh slippages remain under control, incremental provisioning expense is expected to decline. Besides, the bank's profitability was also depressed in last two financial years due to heavy depreciation provisioning on its investment portfolio. However, the bank has substantially derisked its investment portfolio by shifting securities to HTM (AFS less than 35% of total investment book) and reducing modified duration of AFS portfolio to less than 2.0 years.

As a result, we expect Dena Bank's net profit to grow at 104% in FY07. Core operating profit (net of treasury gains) is likely to remain flat in FY07.

❑ Low capital adequacy is a cause of concern

Although overall capital adequacy of Dena Bank at 12.01% as on Sep-06 is comfortable, its Tier-I CAR at 6.01% is low compared to its peer group. The bank is exploring the option of raising hybrid Tier-I capital by issuing perpetual bonds. As per the guidelines, Dena Bank can raise about Rs1.5bn perpetual bonds, which would marginally improve its Tier-I CAR. As GoI holding in Dena Bank is already pegged at 51%, the bank can not go for fresh equity capital issuance. Hence, incremental loan growth of the bank would be as much as its internal accruals can sustain.

Earnings model

Year to Mar (Rs m)	FY03	FY04	FY05	FY06	FY07E
Net interest income	5,681	5,923	6,866	7,227	7,886
yoy growth (%)	28.3	4.3	15.9	5.3	9.1
Other income	4,399	6,198	3,116	4,609	3,484
yoy growth (%)	24.6	40.9	(49.7)	47.9	(24.4)
Trading profits	2,403	4,434	1,178	1,819	500
Non trading income	1,996	1,764	1,938	2,790	2,984
Net revenue	10,080	12,121	9,982	11,836	11,369
yoy growth (%)	26.7	20.2	(17.6)	18.6	(3.9)
Operating expenses	5,113	4,991	6,156	5,613	6,536
yoy growth (%)	11.1	(2.4)	23.3	(8.8)	16.4
Provisions	3,076	3,549	3,873	5,708	3,057
PBT	1,891	3,580	(48)	515	1,776
yoy growth (%)	(1711.8)	89.4	(101.3)	(1179.7)	244.9
Provision for tax	501	1,212	(613)	(275)	266
PAT	1,142	2,305	610	730	1,510
yoy growth (%)	905.2	101.9	(73.5)	19.7	106.9

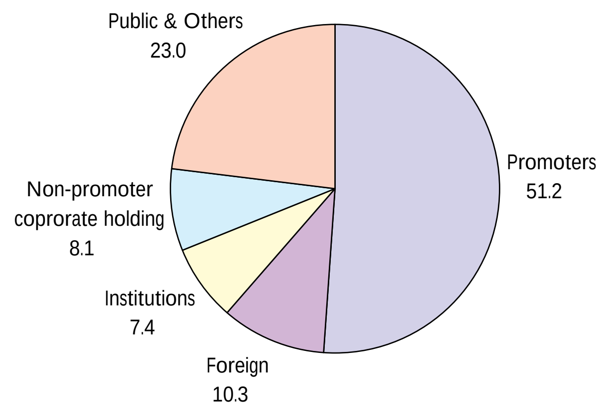
Ratio Analysis

Year to Mar (Rs m)	FY03	FY04	FY05	FY06	FY07E
Net int. margin/avg assets	3.0	2.8	3.0	2.9	2.8
Non-fund rev./avg assets	2.3	3.0	1.4	1.8	1.2
Operating exp./avg assets	2.7	2.4	2.7	2.2	2.3
Cost/Income	50.7	41.2	61.7	47.4	57.5
Prov./avg customer assets	3.4	3.4	2.7	1.9	1.2
PBT/Average assets	1.0	1.7	(0.0)	0.2	0.6
RoA	0.6	1.1	0.3	0.3	0.5
RoE	18.8	31.1	6.3	6.4	10.7
Tax/PBT	39.6	35.6	1,378.8	(41.7)	15.0
Tier I Capital adequacy	3.1	5.2	6.6	6.0	5.3
GrossNPA	17.9	14.8	9.7	6.4	6.2
Net NPA	11.8	9.4	5.2	3.0	2.5
Provisioning coverage	38.3	40.4	48.5	54.4	60.0
Growth in customer assets	10.6	6.1	14.2	21.6	22.3
Growth in deposits	7.4	11.3	13.9	13.0	14.8
SLR Ratio	36.5	41.1	37.4	29.8	26.0

Balance sheet

Year to Mar (Rs m)	FY03	FY04	FY05	FY06	FY07E
Customer assets	84,356	94,118	113,086	142,312	177,891
yoy growth (%)	12.1	11.6	20.2	25.8	25.0
SLR portfolio	62,942	78,991	81,987	72,310	72,632
Cash & bank balances	14,519	14,512	17,820	25,036	28,791
Total assets	198,201	219,516	240,333	265,568	305,110
Networth	6,461	8,379	11,037	13,392	14,902
Deposits	164,913	183,492	208,966	236,231	271,279
- Current	10.3	10.6	10.2	10.1	10.0
- Savings	29.4	31.0	31.9	33.6	33.6
- Term	60.3	58.5	58.0	56.4	56.4
Borrowings	7,753	8,507	10,423	6,083	8,573

Shareholding pattern



As of September 2006

Key valuation metrics

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