

The Economic Times**Title : Are NPA-hit Bank Stocks Worth Investing Now?****Author : Sanket Dhanorkar****Location :****Article Date : 05/18/2016****Marketmen & experts are not sure, with bad loans & operational issues being drags**

The RBI may have gone a little easy on banks while reviewing their asset quality but bad loans show no sign of abatement. Many lenders, especially the public sector ones, have reported higher asset quality slippages requiring higher provisioning for bad loans. With a niggling problem turning into a major crisis, bank stocks have tumbled with the PSU bank index plunging 37% in the past one year. To boot, the PSU bank index lost 11.6% every year for the last five and investors have a pertinent question: Is the worst not yet over for bank stocks?

The banking sector has had a really bad 2015. Loan book growth for 25 banks (after incorporating March numbers) -both private and public -stood at 10.7% in FY16, the slowest in nearly two decades. Moreover, total gross non-performing assets for these banks nearly doubled to `2.43 lakh crore during the last financial year. This sharp uptick in NPA numbers was mainly due to the mandatory asset quality clean-up norm from RBI that requires banks to fully recognise and provide for non-performing loans. However, the quantum of provisioning and additional slippages in the March quarter have come as a surprise to analysts.

Particularly, Bank of Baroda's continuing bad loan troubles were a shocker for the market. After reporting a loss of `3,342 crore in the December quarter due to a `one-off' provisioning for bad loans, the lender suffered a big loss of `3,230 crore for the March quarter. While announcing the December quarter numbers, the bank's management had said the worst was over since it had taken the entire provisioning hit in a single quarter, unlike other banks which spread it out over several quarters. The extent of additional provisioning by the bank indicates higher-than-anticipated stress in balancesheets. Numbers from the largest lender SBI are still awaited and could reveal a deeper malaise.

Which is why experts are not so sure whether the worst is over for government banks. "We are not comfortable with PSU banking stocks yet. More bad news could be in the offing and the price does not look cheap relative to fundamentals," says Vikas Gupta, CIO, ArthVeda Capital. Within the PSU banking space, mid-sized banks like Allahabad Bank, Dena Bank, Union Bank of India and Andhra Bank are in a bigger soup. Apart from high assetquality stress, mid-size public sector banks face operational issues too, says Edelweiss Securities in a report. "We perceive clear demarcation between large and mid-size PSU banks and expect pressure to continue in latter. Given increasing Basel III (capital adequacy) requirement and limited capital support from government, dilution risk is imminent at weak multiples, which will be detrimental to shareholders' returns," says the report.

Despite the troubles, several state-owned bank stocks have seen a smart upswing since mid-February after the RBI announced that it would go easy on asset quality review. The passage of the Bankruptcy Bill also provided a boost. The sharp fall in prices earlier also supported the rally. Price of most banking stocks again took a beating following the weak results. Most PSB stocks still trade at a discount to the book value, leading some to argue that the downside for these stocks is limited and that they could be great value picks at current valuations. "The valuations of PSU banks largely factor in the potential stressed loans and weak core operating performance for FY17," argues Alpesh Mehta, research analyst, Motilal Oswal Securities, but maintains that he prefers private banks over state-owned ones.

But independent market expert Ambareesh Baliga assert that the risk-reward is more in favour of PSU banking space given that the market has discounted asset quality pangs. "Public sector banks are now entirely naked and not likely to provide any further surprises. However, risks are more prominent in private banking stocks where negative results have come as a surprise." ICICI Bank and Axis Bank are two private lenders which posted weaker-than-expected numbers in the March quarter and also

came out with weak guidance for this fiscal. While ICICI Bank has indicated likely stress in Rs 44,000 crore worth of loans going forward, Axis Bank has put Rs 22,628 of loans on watch-list. A few private banking stocks such as Yes Bank, IndusInd Bank, HDFC Bank and Kotak Mahindra Bank have displayed consistent resilience to the NPA issue. These banks are retail-centric where asset quality issues are under control. Not surprisingly, these stocks have surged over the past few months.

NOT WORTH A BUY

We are not comfortable with PSU banking stocks... More bad news could be in the offing & the price does not look cheap relative to fundamentals

Vikas Gupta
CIO, ArthVeda Capital

| PSU Banks Continue to Report High NPA Stress... | | | | |
|---|-------------------------------------|---------------------|-----------------------------|------|
| Company | Gross NPA (as % of total assets) | Gross NPA (₹ cr) | 3 month price change (%) | P/BV |
| UCO Bank | 15.43 | 20,908 | 7.9 | 0.33 |
| Central Bank | 11.95 | 22,721 | 48.8 | 0.8 |
| Bank of Baroda | 9.99 | 40,521 | 8.5 | 0.75 |
| Dena Bank | 9.98 | 8,560 | 6.1 | 0.25 |
| Allahabad Bank | 9.76 | 15,385 | 19.6 | 0.23 |
| ...But Most Private Sector Ones Stay Resilient | | | | |
| Yes Bank | 0.76 | 749 | 33.6 | 2.99 |
| IndusInd Bank | 0.87 | 777 | 29.5 | 3.72 |
| HDFC Bank | 0.94 | 4,393 | 19.5 | 3.96 |
| DCB Bank | 1.51 | 197 | 26.8 | 1.54 |
| Axis Bank | 1.67 | 6,088 | 20.0 | 2.17 |

Complied by ETIG Database Data as on May 13, 2016

RISK & REWARD
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