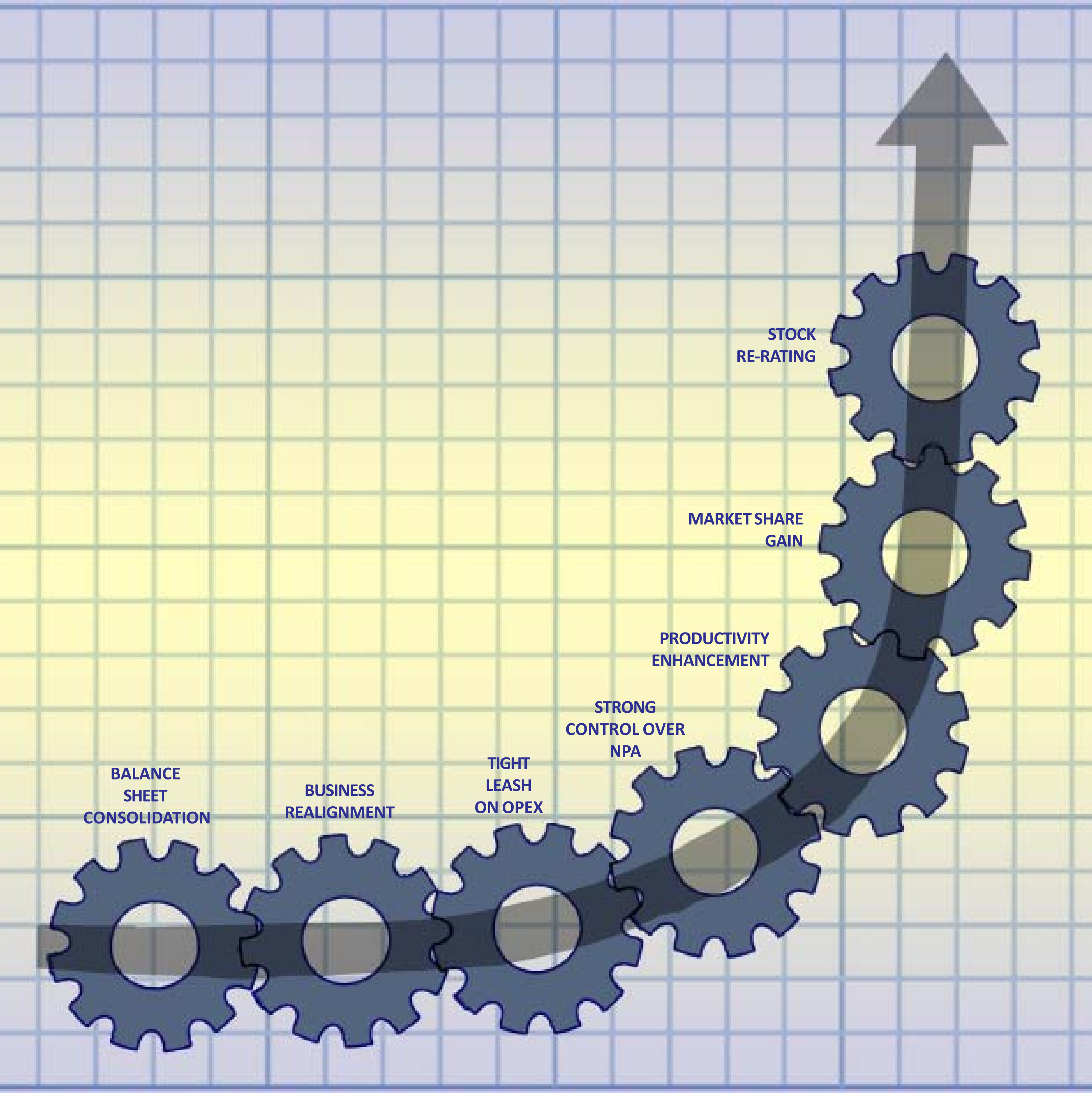
MOTILAL OSWAL

Initiating Coverage | 24 March 2015
Sector: Financials

DCB Bank



Wheels of growth in motion

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DCB Bank: Wheels of growth in motion

DCB Bank

BSE Sensex	S&P CNX
28,162	8,543

DCB BANK

CMP: INR106 TP: INR155 (+46%) Buy

Wheels of growth in motion

To capitalize on 'pool of wealth' | Re-rating imminent

- **DCBB, one of the 10 private banks that received licenses in 1994, has undergone significant restructuring over the last five years: (a) Loan book realignment to secured and lower ticket size loans, (b) Cost rationalization through manpower optimization, branch relocation, and cutting flab, and (c) Focus on building a granular liability profile.**
- **Structural and operational changes by the management to improve productivity and efficiency (post 2009) are leading to improvement in core PPP. Having achieved PBT of 1.5% (as percentage of assets) from a loss of 1.3% in FY09, the management's focus would shift to scalability.**
- **Given its strong SME presence, expanding branch network (now 145 branches) and healthy capitalization (tier-I ratio at 14.5%), we believe DCBB is well poised to capitalize on the 'pool of wealth' [click here for our theme report, "Pool of Wealth" dated March 3, 2014]. The bank's loan market share (15bp currently) should improve, aided by loan CAGR of ~30% over FY15-17.**
- **Significant focus on core operating profitability, and strong growth in granular retail and niche small-ticket SME loans would drive further re-rating. We initiate coverage with a target price of INR155 (2.2x FY17E BV).**

Balance sheet re-aligned; focus on scale now

DCBB posted loan CAGR of 24% over FY11-14, despite realignment of retail (unsecure to secure) and SME loans (ticket size reduced), and move to lower ticket corporate loans. With loan realignment behind, scale build-up in niche areas of presence, branch expansion, and healthy tier-I ratio, we estimate loan CAGR of 30% (~14% CAGR for the industry) over FY14-17. Focus on granular and collateralized SME and retail loans would keep asset quality healthy.

Productivity gains to add 25bp+ to pre-tax RoA

To cut flab in the system, DCBB relocated some branches, reduced branch size, controlled overheads, and rationalized manpower over FY09-14. This led to ~100bp reduction in opex to assets to 2.6%. Tight control over cost and productivity improvement, coupled with high growth would boost profitability going forward. C/I ratio should fall to ~54% (63% in FY14) and productivity gains to contribute 25bp+ to PBT by FY17. However, ROAs would decline marginally as DCBB moves to full tax rate in FY15.

Core earnings to remain healthy; re-rating to continue

We expect core revenues to clock a healthy CAGR of 26% over FY14-17, driven by strong loan growth and largely stable margins. Controlled opex and decline in C/I ratio would drive core PPP/PBT CAGR of ~35%, though increase in tax rate to 30% would keep earnings CAGR lower at 20%. Return ratios are likely to be in-line/better than industry average. As the bank delivers on core profitability, asset quality and market share, re-rating would continue. We initiate coverage with a target price of INR155 (2.2x/16.4x FY17E BV/EPS).

Stock Info

Bloomberg	DCBB IN
Equity Shares (m)	280.8
52-Week Range (INR)	127/57
1, 6, 12 Rel. Per (%)	-2/14/53
M.Cap. (INR b)	30.9
M.Cap. (USD b)	0.5
Avg Val. INRm/Vol'000	138/1,504
Free float (%)	83.6

Financial Snapshot (INR b)

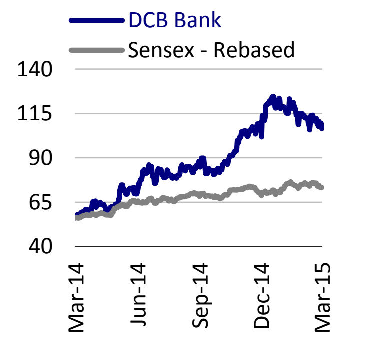
Y/E Mar	2015E	2016E	2017E
NII	5.1	6.1	7.5
OP	2.8	3.6	4.6
NP	1.7	2.0	2.6
NIM (%)	3.8	3.7	3.6
EPS (INR)	6.0	7.3	9.4
EPS Gr. (%)	11.8	21.1	29.2
BV/Sh.INR	55.2	62.1	71.3
P/E(x)	17.6	14.5	11.2
P/BV (x)	1.9	1.7	1.5
RoE (%)	12.8	12.5	14.2
RoA (%)	1.2	1.2	1.2

Shareholding pattern (%)

As on	Dec-14	Sep-14	Dec-13
Promoter	16.4	18.4	18.5
DII	24.3	16.4	15.0
FII	15.5	14.8	11.9
Others	43.8	50.4	54.6

Note: FII Includes depository receipts

Stock Performance (1-year)



DCB BANK: TIMELINE

2014
- Number of branches increase to 145
- Raised INR2.5b through QIP at INR82

2013
- Rating upgrade by CRISIL to 'CRISIL A-/Stable'
- Expansion in branch network resumes

2010
- Re-alignment of loan book; consolidation in unsecured book
- Focus on cutting costs

2009
- DCB appoints Mr. Murali M. Natrajan as MD & CEO

2006
- Raised INR1,860m through IPO; Issue subscribed 36x
- GNPA ratio at a new high of 15%

2005
- AKFED infuses capital in the bank; Mr. Nasser Munjee appointed as Chairman
- However, DCB reports PBT loss of due to ongoing stress
- Consolidation efforts begin

2004
- Classified as a "New Generation Private Sector Bank" by RBI

2003
- GNPA ratio increased to double digits (11.6%) led by higher stress in corporate book

1995
- Bank gets a Private Banking License; becomes Development Credit Bank (a Scheduled Commercial Bank)

1981
- Named Development Co-operative Bank Ltd post amalgamation of Ismailia and Masalawalla co-operative banks

1930
- Origin of the bank goes back to a series of mergers of Co-operative banks in 1930

Impressive turnaround in operations

Consolidated operations by focusing on granular and secured loans

- **Until FY09, DCBB was saddled with significantly high impaired loans (GNPA of 8.4%) and low productivity (opex-to-assets of 3.6%). The new management, which took charge in May 2009, has achieved an impressive turnaround in operations. As at the end of 9MFY15, GNPA was 1.9% and opex-to-assets stood at 2.7%.**
- **With stability at the top management level (in turn business strategy) and focus on niche areas (SME loans and mortgages), DCBB has seen improvement in productivity and profitability (RoA of 1.3% in FY14 versus loss of 1.3% in FY09). Execution in all three phases (consolidation, rebalancing, and scale-up) has been commendable.**

Frequent management/business strategy changes impacted performance

- Led by frequent management change and in turn business strategies, DCBB remained a laggard among the 10 banks that were awarded private bank licenses in 1993.
- Over FY03-06, DCBB reported losses, led by higher slippages in the corporate segment, resulting in low NIMs and higher credit cost. In FY05-06, it reported operating loss too.

Focus on revenue growth to cover costs led to compromise on asset quality

- Strong expansion (employees up from 1,279 in FY06 to 2,235 in FY08), and CBS-related cost led to high opex growth over FY06-08. To cover higher costs, the management focused on rapidly expanding revenues.
- Focus on revenues coupled with strong capitalization and excess liquidity in the system led to high risk appetite. DCBB expanded aggressively in unsecured retail and CV loans.
- Aggressive growth in risky products, global financial crisis and RBI's tough measures for recovery of retail loans impacted operations yet again and DCBB slipped into the red.

Since May 2009, there has been an impressive turnaround

- Immediate focus of the new management (joined in May 2009) was to realign organizational structure to bring cost efficiencies and consolidate balance sheet growth (loans CAGR of 3% over FY08-11). Cost rationalization by branch reallocation, cutting flab, and focusing on productivity improvement resulted in a fall in opex to average assets from 3.7% in FY08 to 3.2%. Opex CAGR during the period was -2%.

Opex to average assets down from 3.6% in FY09 to 2.6%

- Saddled with high NPAs (GNPA of 9% as at the end of FY09), the management focused on running down unsecured exposure and making attempts to boost recoveries. The bank's loan portfolio shrank 15% over FY08-10. The share of these unsecured loans has declined from 32% in FY08 to less than 2% in 9MFY15.
- Gradually, the management started focusing on granular retail and SME loans and reduced reliance on large ticket corporate loan exposure. Scaling down of operations in large corporate business also impacted bulk deposits. However, the bank welcomed this, as it was de-growing on the assets side.

Exhibit 1: Opex CAGR 6% FY09/14; Ratio at a decadal low…

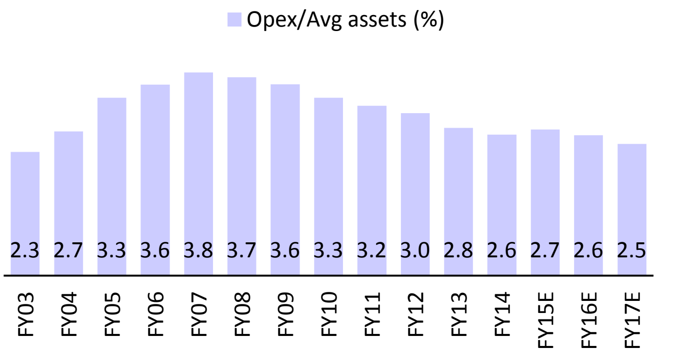


Exhibit 2: …led by cutting the flab in the system

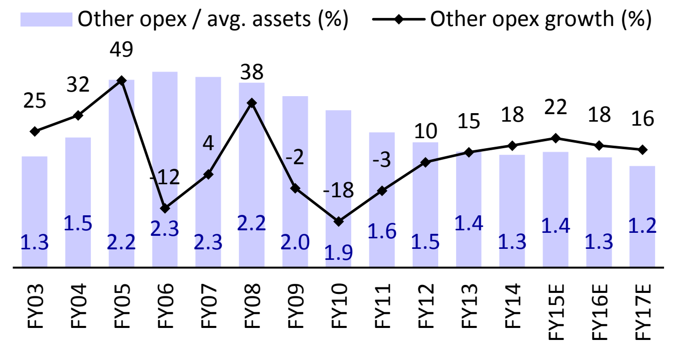


Exhibit 3: Controlled opex and healthy revenues driving C/I ratio lower (%)

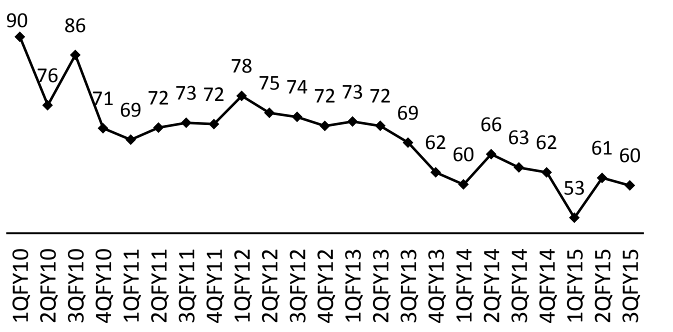


Exhibit 4: Slippages and credit costs spiked during FY08-10, partially led by decline in loans

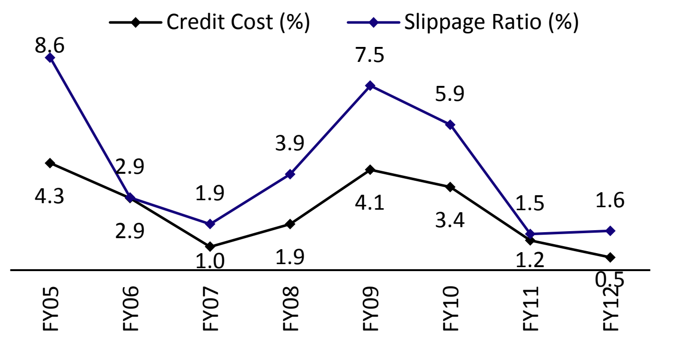


Exhibit 5: Mortgages key driver of growth

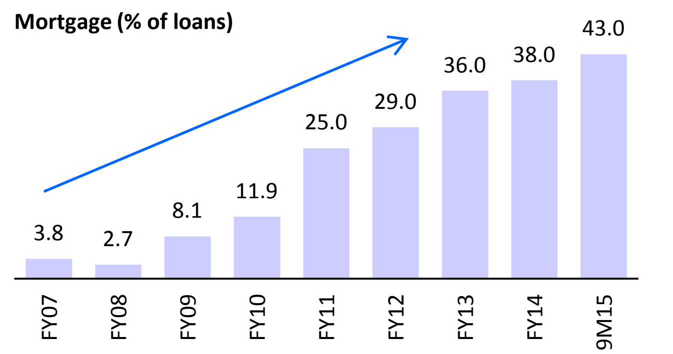


Exhibit 6: SME volume growth healthy; Shift to lower ATS leading to decline in proportion (%)

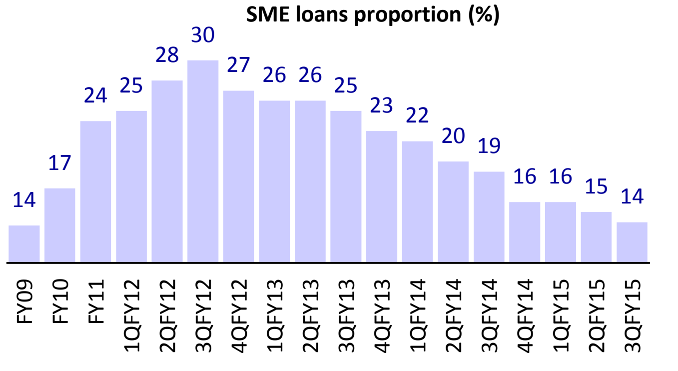


Exhibit 7: Steady decline in exposure to top-20 accounts (%)

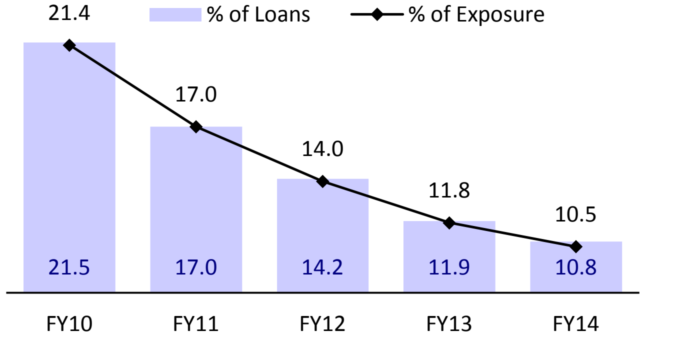
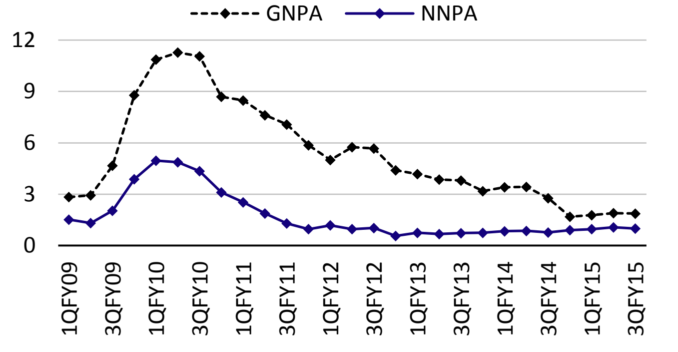


Exhibit 8: … resulted in considerable decline in NPAs (%)



Source: Company, MOSL

Source: Company, MOSL

Balance sheet re-aligned; focus on scale now

Market share gain to accelerate

- **Post the consolidation phase, DCBB's focus shifted to improving the share of granular business on both assets and liabilities side. On the assets side, mortgages (largely LAP), low-ticket SME exposure, and agri-banking were the key focus areas.**
- **On the liabilities side, focus was not only to provide stability via high share of retail deposits but also to minimize asset-liability mismatches. The management had taken a conscious decision of not increasing the share of bulk deposits to over 25%.**
- **DCBB is now focusing on building scale with tight leash on opex, well balanced granular loan mix, and improved risk management.**

Low ticket secured loan exposures – a key focus area for growth

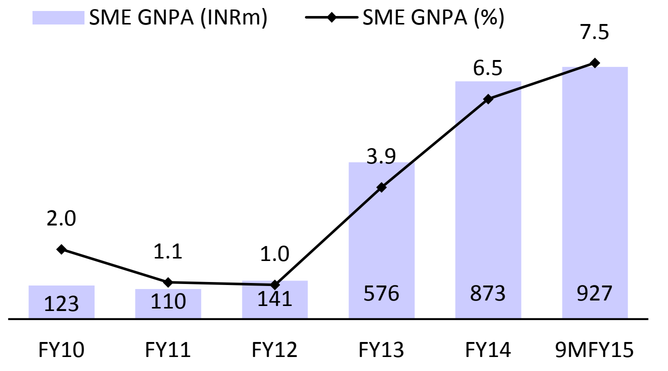
- Post consolidation, the management led by Mr. Natrajan focused on secured retail loans (LAP and HL), low-ticket SME loans (exposures up to INR100m), agri and inclusive banking (to reduce drag of PSL), and trade-related corporate loans for incremental growth. DCBB consciously moved away from unsecured personal loans, CV loans (however, it is now back in the market for PSL loans), and bulky corporate loans.
- Apart from in-house sourcing, DCBB also relied on DSAs and acquired portfolios for growing mortgage loans due to constraints on opex.
- Scale-up of branch network, with focused strategy (either #1 or #2 private bank in the area and largely SME cluster areas), strong capabilities in SME and retail loans, and healthy risk management practices will help DCBB to grow at least 2x faster than the industry. DCBB's targeted long-term loan mix is: Retail 40%, MSME 25%, Corporate (largely trade related) 25%, and AIB 10%.

Reducing ticket size on SME loans in a high risk environment

The proportion of SME loans declined from 30% in 3QFY12 to 14% in 9MFY15; the portfolio is now more granular and healthy; expect growth to resume

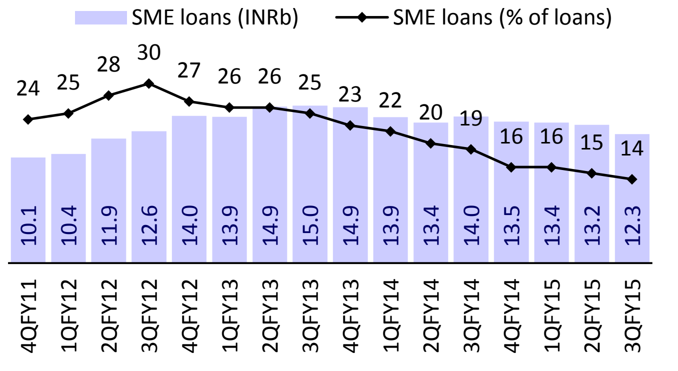
- An important focus area for the new management was to capitalize on DCBB's niche presence in the SME segment (strong relationships with the trader community). Initially, the target for SME loans were customers with business turnover of INR100m-INR1b and lines up to INR100m. However, with increasing risk in the system, DCBB moved to the relatively lower ticket size of INR30m-60m.
- In absolute terms, SME loans have been flat since FY12. As a percentage of the overall loan book, SME loans have declined from a peak of 30% in 3QFY12 to 16%, led by higher repayments/non renewal of high ticket SME loans.
- DCBB's current SME loan book is more granular. Small ticket loans, especially working capital loans, provide DCBB diversification, strong risk-adjusted yields, adequate collateral, and PSL exposure. With improving macroeconomic conditions and the bank's niche expertise, we expect this business to scale up. The management expects a CAGR of 25%+ over FY14-17.

Exhibit 9: Increasing NPAs in SME loans led to risk aversion…



Source: Company, MOSL

Exhibit 10: …and decline in proportion of SME loans



Source: Company, MOSL

Post consolidation in SME portfolio, management is again looking at growing this segment aggressively

Exhibit 11: DCBB - Deep dive into SME segment

Share in loan book	14% as on 9MFY15
Key products	Business banking, working capital financing, and CC/OD
Ticket size	INR30m-60m
Yield	Interest rate on SME book is 13-14%
Fees	Bank earns 1-1.5% fees on SME products, higher transaction-related fees from CC/OD, and trade income
Assessment capabilities	• Over the years, DCBB has developed a strong credit risk team • Sanctioning authority based on loan application amount • Business development and credit approval/risk team are separate verticals, with separate management reporting
Security/Collateral	• Primary residential property of the promoter • Linking of cash flows to repayment schedule is important
Sourcing	• Dedicated sourcing team works closely with branches for sourcing of SME loans • Most customers are clients of state-owned banks, unhappy with their execution capabilities; DCBB consistently provides low TAT and competitive yields • DCBB extensively relies on in-house servicing and dependence on DSAs is on the lower side
Customer profile	• SMEs with turnover of INR30m-60m • Customers typically unhappy with client servicing of state-owned banks • NBFC clients in need of larger bouquet of products

Source: MOSL, Company

Exhibit 12: Advantage DCBB vs NBFCs

Differentiator	Details
Pricing	DCBB's pricing is at least 200-500bp lower than NBFC peers.
Products	NBFCs offer a bouquet of products including working capital financing, term loans, non-funded facilities, and salary accounts.
Cash Management	Various cash management products are also a key differentiator vis-à-vis NBFCs.

Source: MOSL, Company

Secured mortgages – a key growth driver

Focus on growing secured loan book and decline in overall loans (led by unsecured loans) led to higher share of mortgages in overall loans

- While DCBB consciously slowed down growth in personal and CV/CE loans, it enhanced focus on mortgages. Over FY09-9MFY15, its mortgage portfolio grew at a CAGR of 57% against 20% CAGR in overall loan book. Mortgages now constitute ~43% of its loan book against just 8% in FY09.
- The bank has built its mortgage portfolio, both directly through its own branches as well as by acquiring portfolios. While growth in the acquired portfolio has been significant, it has also demonstrated traction in its self-originated mortgage portfolio.
- Loans against property constitute ~65% of its mortgage portfolio, while home loans constitute ~35%. Risk management practices are in place and the management is focused on growing this book. We believe DCBB is well placed to gain market share in this segment.
- Careful selection of DSAs and an aged portfolio, which has stood the test of time, have helped the bank to grow as well as manage asset quality. GNPA and NNPA have declined from a peak of 11.3% and 4.9% in 2QFY10 to 1.9% and 1.0%, respectively in 9MFY15, and credit cost has declined from a peak of 4.1% in FY09 to 0.4% in FY14.

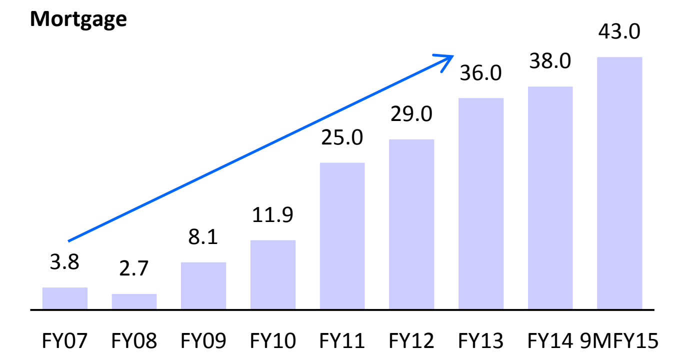
Mortgage segment would remain a key growth driver for the bank

Exhibit 13: DCBB: Deep dive into mortgages segment

Share in loan book	• 43% as on 9MFY15 • LAP accounts for ~65% of mortgages segment
Key products	• Loans against property (LAP) • Housing loans
Ticket size	INR3m-6m
Yield	• Yield on LAP book is 13-14% • Home loan (HL) yield is 12-13.5%
Tenure	• Contract maturity of ~12 years • However, LAP is generally repaid in six years
Security/Collateral	• Primary residential property of the promoter • Linking of cash flows to repayment schedule is important
Sourcing	• ~50% of LAP sourced through client referrals • Balance transfer from NBFCs accounts for significant proportion of new disbursals
Customer profile	• Mostly SME customers residing in primary residential properties • Mainly non-salaried borrowers for housing loans

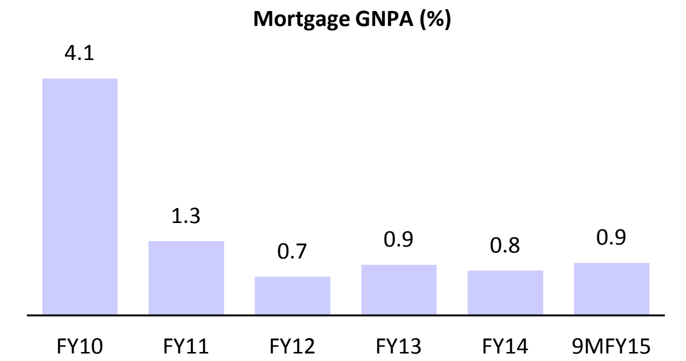
Source: MOSL, Company

Exhibit 14: Significant rise in proportion of mortgage loans…



Source: Company, MOSL

Exhibit 15: …has managed asset quality well



Source: Company, MOSL

Focusing on working capital loans in corporate segment

Focusing on working capital financing in corporate segment

- Small balance sheet size restrains DCBB's growth in the corporate segment. Its small size affects its ability to absorb asset quality shock.
- DCBB has been focusing more on working capital loans in the corporate lending business. It does not actively participate in project loans as part of consortiums; its size limits its bargaining power.
- The decline in its exposure to top-20 accounts from 21%+ in FY10 to 10.5% in FY14 reflects its diversification strategy and focus on building a granular book.

Exhibit 16: Working capital financing is a key focus area for corporate loan growth

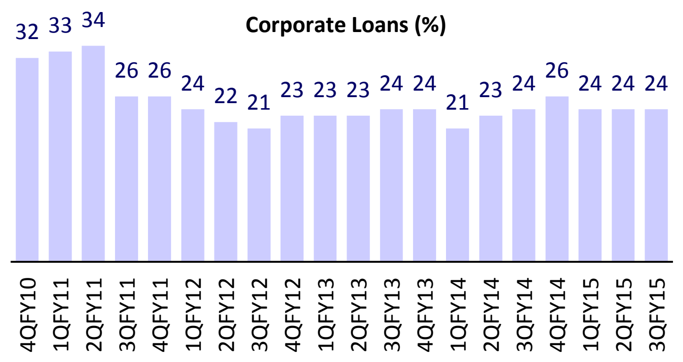


Exhibit 17: GNPA ratio in the corporate portfolio steadily declining; high write-offs in recent quarters led to sharp drop

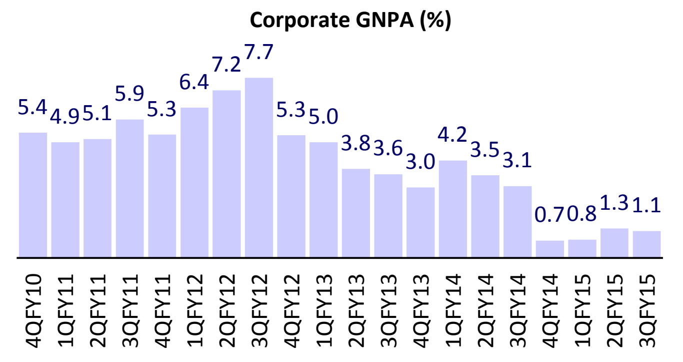
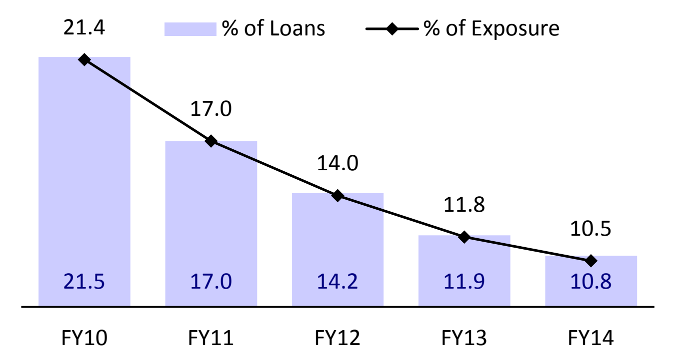
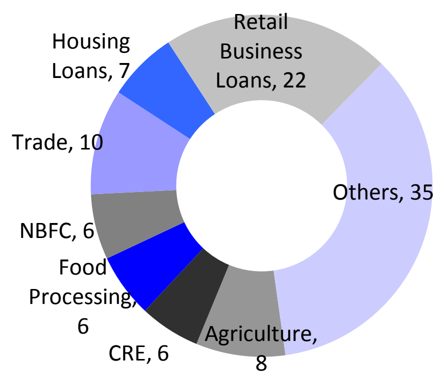


Exhibit 18: Steady decline in exposure to top-20 accounts (%)



Source: Company, MOSL

Exhibit 19: Has diversified corporate portfolio (%)



Source: Company, MOSL

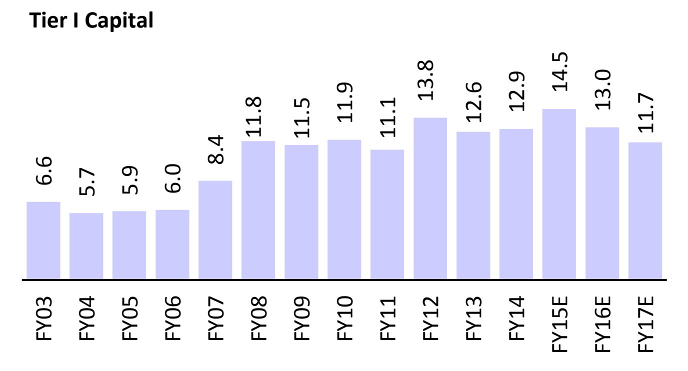
Poised to deliver above industry growth, gain market share

We factor in loan CAGR of ~30% over FY14/17 with market share rising to 0.2% - significant scope for increase

Capitalization/ expansion no longer a constraint like it was in the previous growth cycle

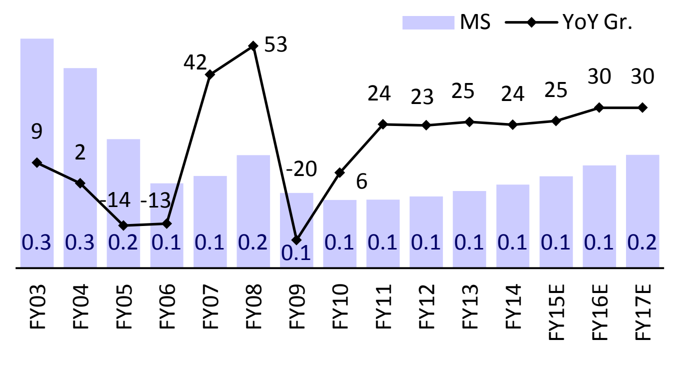
- With portfolio realignment behind and given DCBB's strong expertise in the SME segment, we now expect it to gain market share. Demand for mortgages, loans against property (LAP) and SME loans remain healthy – a key focus area for DCBB.
- Post consolidation over FY08-10, DCBB almost doubled its balance sheet (~24% loan CAGR) over FY11-14. It has a market share of just ~15bp in systemic loans.
- DCBB is focusing on expanding to tier-II and below cities, where it would be the number-1 or number-2 private sector bank and have a large catchment to cover for SME loans.
- Given its small size (DCBB's loan market share is <0.15%) and strong growth opportunities in its focus areas, we expect DCBB's overall growth to remain healthy at ~30%. Capital is unlikely to be a constraint with CET1 of 13.6%.

Exhibit 20: Capitalization was a concern in first growth phase; now at healthy level (%)



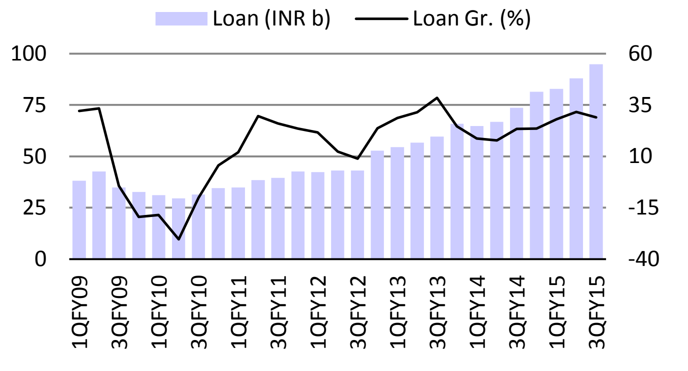
Source: Company, MOSL

Exhibit 21: Asset quality impacted growth; with volatility behind, expect sustainable market share gains (%)



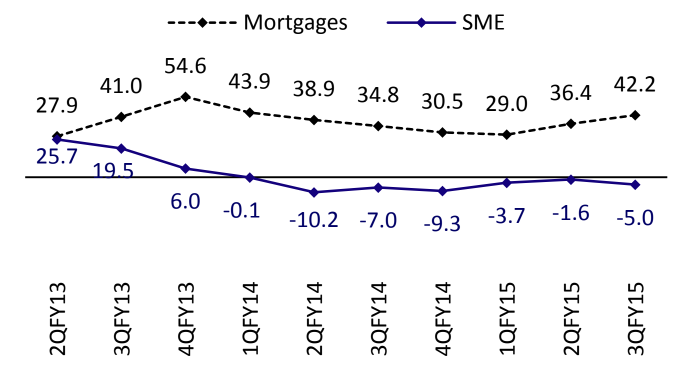
Source: Company, MOSL

Exhibit 22: Phase of loan realignment, during which…



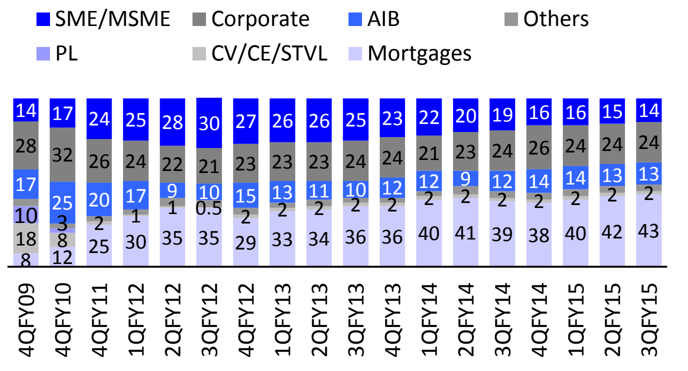
Source: Company, MOSL

Exhibit 23: …DCBB shifted focus towards mortgages (YoY growth; %)



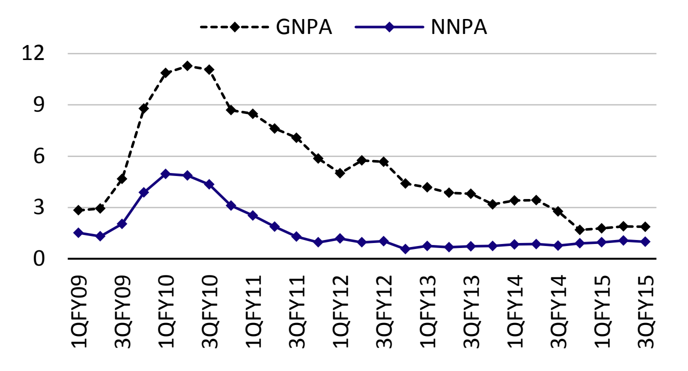
Source: Company, MOSL

Exhibit 24: Loan mix in favor of granular - secured loans (%)



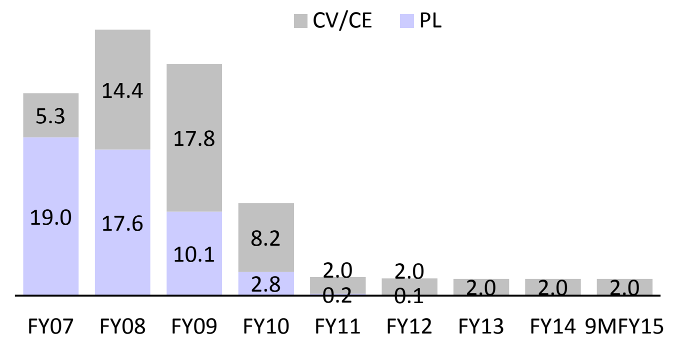
Source: Company, MOSL

Exhibit 25: GNPA and NNPA declined considerably (%)



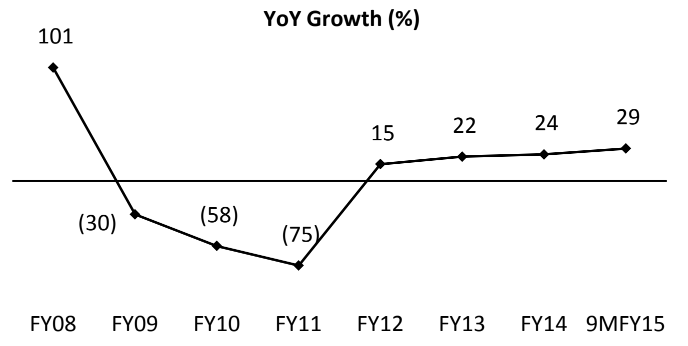
Source: Company, MOSL

Exhibit 26: Sharp reduction in risky retail assets… (% of loans)



Source: Company, MOSL

Exhibit 27: …expect gradual growth increase in these segments as CV picks up



Source: Company, MOSL

Increased reliance on retail deposits to fund growth

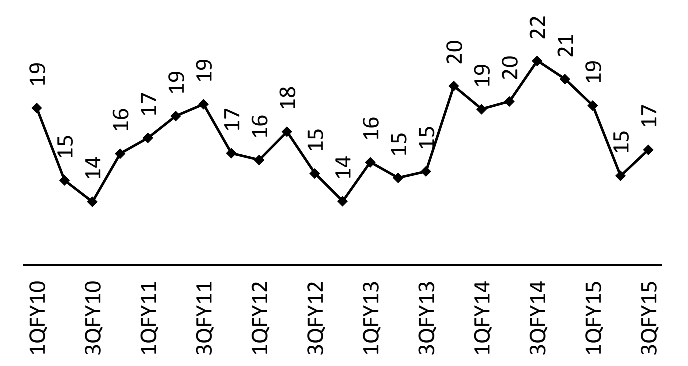
Proportion of bulk deposits is sub-20%, one of the lowest among peers

- With the intention to de-risk its balance sheet, DCBB shifted its focus to CASA and retail deposits during the consolidation phase. This led to the proportion of retail deposits + CASA deposits increasing from 52% in FY08 to 78% in FY13, lending access to a stable funding source. The proportion of wholesale deposits is just 18%, at least 10% lower than most of its larger peers.
- DCBB's branch network is primarily concentrated in the metros, within which the top-4 cities contribute significant proportion of business.

Increase in branch network to aid traction in retail deposits growth

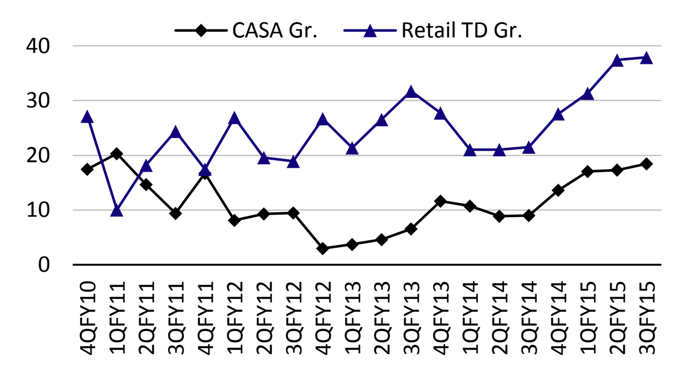
- Further, expansion would help DCBB to accelerate CASA growth and maintain healthy momentum in retail term deposits.
- Focus was not only on increasing granularity, but also on improving asset-liability management. In some buckets, DCBB's deposit rates remain 25-50bp higher than peers.

Exhibit 28: Wholesale deposits remain lower than peers (%)



Source: Company, MOSL

Exhibit 29: Healthy growth in retail term deposits (YoY growth; %)



Source: Company, MOSL

Increased footprint to help augment CASA

Stability/improvement in CASA ratio, which has declined significantly in the last few years, would help contain cost of funds and favorably impact NIM

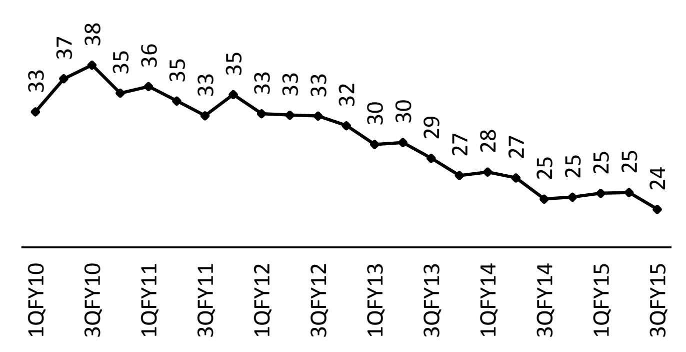
- With higher loan growth (CAGR of 24% over FY11-14) and moderation in CASA growth (CAGR of 10% over FY11-14), CASA ratio declined from 35% to 25%.
- Besides economic factors, the reasons for moderation in CASA growth are stagnant branch network (94 branches at the end of FY13; added 14 branches over FY08-13), increased competition following deregulation of SA rates (DCBB offers 4%), and decline in systematic CA ratio.
- DCBB has resumed its expansion strategy and added 36 branches in FY14. This should help improve customer acquisition and CASA growth, and contain the sharp fall in CASA ratio. However, expected strong loan growth and heightened competition would continue to drag CASA ratio.

Exhibit 30: DCBB: Main criteria and process of opening a branch

Step	Action
1	Select a village with 5,000 middle income households
2	Penetration of private banks should be low
3	Town should be on the periphery of a large town or town is expected to become an industrial town/smart city in future
4	Credit repayment culture with the state/district is critical
5	Town should be in the vicinity of an existing cluster

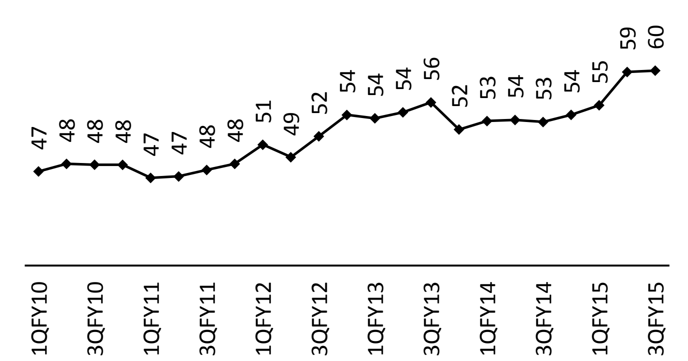
Source: MOSL, Company

Exhibit 31: CASA ratio has moderated with acceleration in growth (%)



Source: Company, MOSL

Exhibit 32: However, proportion of retail term deposits rising (%)



Source: Company, MOSL

Greater focus on asset quality; credit cost to remain low

Comfort on asset quality, led by improved risk management and higher proportion of secured loans; credit cost is expected to be at a low of ~40bp

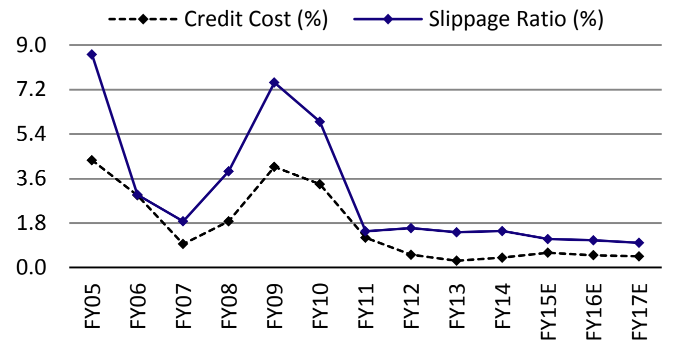
- Asset-side restructuring also led to sharp improvement in asset quality, even during the most trying times for the Indian economy. GNPA and NNPA fell from 8.7% and 3.1%, respectively in FY10 to 1.7% and 0.9% in FY14 (1.9% and 1.1% in 9MFY15). Standard restructured loan portfolio remains low at ~1% of loans.
- With systems and processes in place, strong backend technology, and the bank's prudent approach, we expect asset quality to remain healthy (NNPA below 1.5%) and credit cost to be contained (0.4% over FY14-17).
- PCR (including technical write-offs) remains strong at ~77%, the best in the sector, which provides comfort.

Exhibit 33: DCBB: Strong collection mechanism to support asset quality performance

Overdue for	Action
Before due date	Phone call from the centralized call center
	SMS notification
0-30 days	Based on payment default (bounce) data, follow up through call center begins (soft calling)
30-60 days	Follow-up by branch staff
60-90 days	Rigorous collection efforts through cluster-based collection team (~50% of overdues generally get cleared through this)
90+ days	Account becomes NPA; legal proceedings including SARFASI initiated

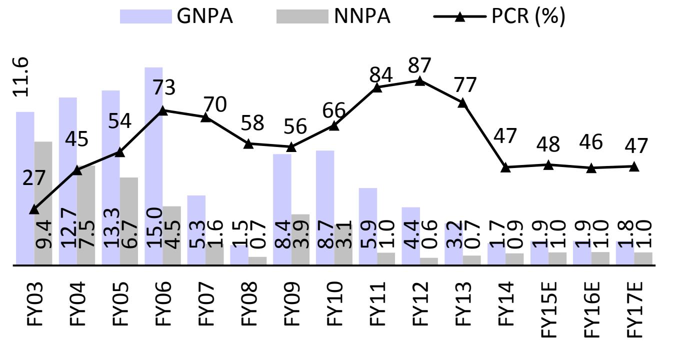
Source: MOSL, Company

Exhibit 34: Improved risk management practices, prudency and higher proportion of secured loans to help sustain strong asset quality performance



Source: Company, MOSL

Exhibit 35: NNPA near historical lows; PCR (including technical write-offs) at 77% in 9MFY15



Source: Company, MOSL

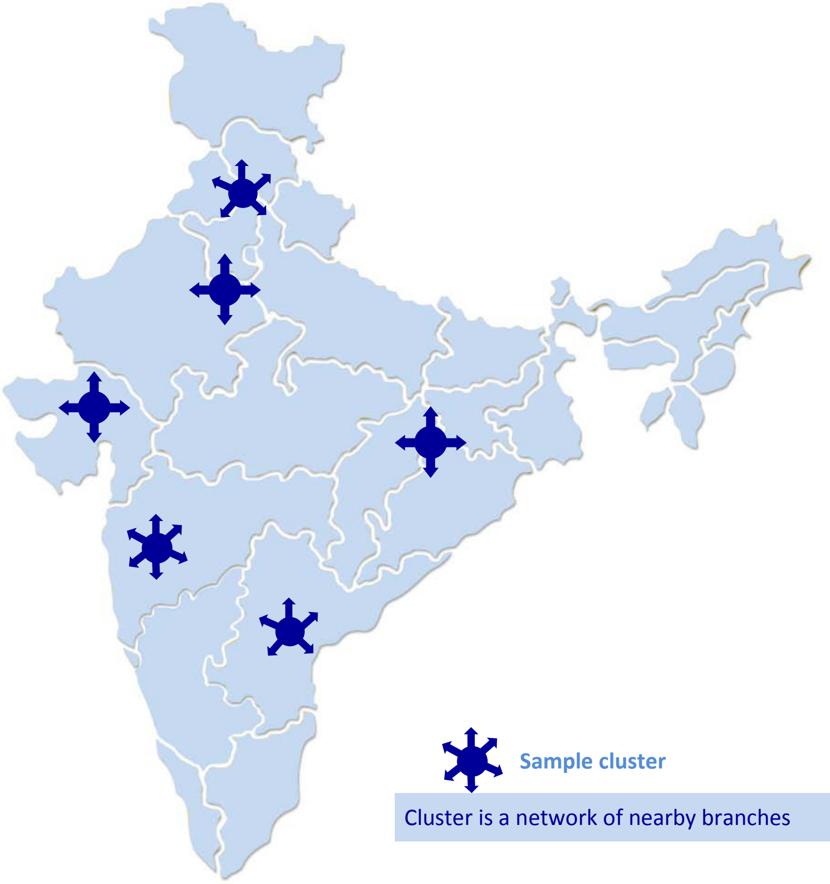
How DCB plans to improve profitability?

Opex ratios to soften, led by innovative cluster-based model | Balanced scorecard to aid total income

Cost savings through Cluster based business model

- ✓ Cluster based audit and training team saves frequent travelling costs
- ✓ Localized loan sanctioning authority have better understanding of the polito-economic situation of the area
- ✓ Coordinated recovery and collection efforts

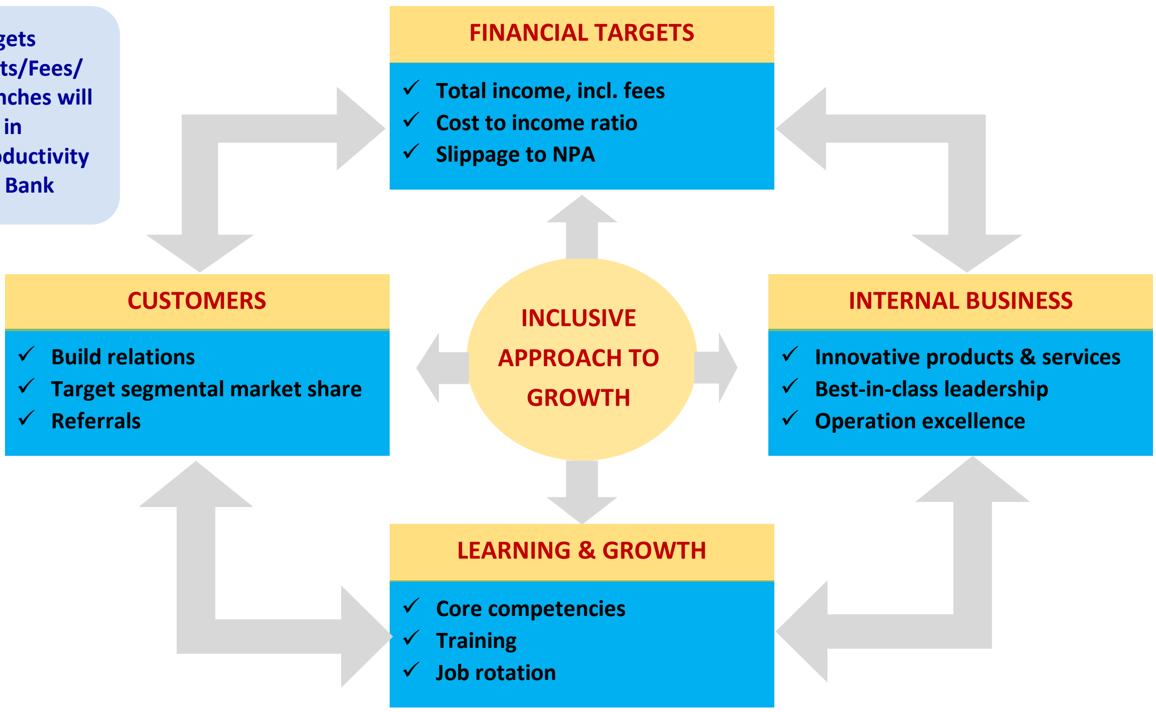
State	Branches	% share
Maharashtra	35	24
Mumbai & suburbs	27	19
Gujarat	23	16
Andhra Pradesh	15	10
Odisha	14	10
Madhya Pradesh	13	9
Others	45	31
Total	**145**	**100**



Diagrams for the purpose of representation only

DCB: Balance scorecard aimed at improving productivity matrix

Individual targets (Disbursements/Fees/ Opex) for branches will go a long way in improving productivity matrix of DCB Bank



Diagrams for the purpose of representation only

Core earnings to remain healthy

Capacity additions to aid growth | Productivity gains to drive C/I ratio lower

- **DCBB has again begun investing in branches and people. Incremental branches are coming up in tier-II to tier-VI centers, where operating costs are lower and breakeven time is less than in tier-I centers. We believe productivity gains would more than compensate for the increase in costs.**
- **NIMs are expected to be stable, as (a) DCBB is poised to benefit from declining systemic interest rate (higher proportion of liabilities maturing within a year compared to loans), (b) augmentation of retail deposits to help contain cost of funds, and (c) growth in high yielding loans remains strong. NII CAGR of ~27% and operating leverage would drive core PPP CAGR of 35%+.**
- **Prudent and secured lending would keep credit cost low at 0.5% (similar to FY14 levels), resulting in PBT CAGR of 35% over FY14-17. Earnings CAGR would be lower at ~20% due to expected increase in effective tax rate.**

Resumption of investment into creating long-term business model

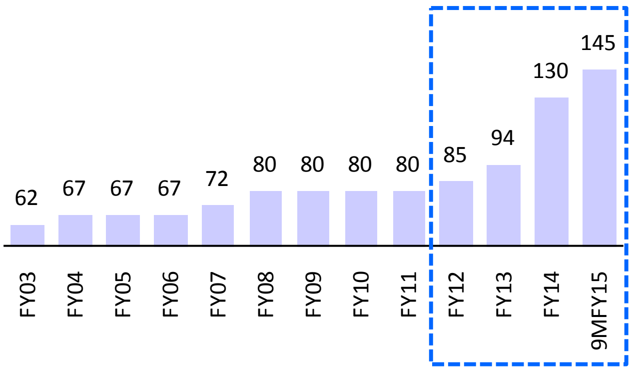
Cost-to-average-assets fell from 3.6% in FY09 to 2.6% in FY14 – focus on improving productivity

- DCBB's high cost structure coupled with lower productivity impacted its ability to deliver higher return ratios. In FY10, its cost-to-income ratio was 90%+ and opex-to-average-assets was significantly higher than peers at 2.7% (2.2% for private bank universe).
- During the consolidation phase, DCBB focused on improving productivity. It opened only 15 branches over FY09-13. As of FY09, employees per branch were significantly lower than peer banks. To improve productivity, it moved a large proportion of the employees to client facing or revenue generating activities.
- DCBB has begun making fresh investments in network expansion. It has added 36 branches in FY14 and 15 branches in 9MFY15 (versus 15 branches over FY09-13). The bank has directed a large part of its fresh investments outside tier-I centers, where operating costs are lower and breakeven can be achieved quicker. DCBB is expanding into locations where it would be either the first or the second private sector bank, enabling it to achieve higher retail and SME business growth.

Further improvement in productivity to bring down cost-to-income ratio to 56% and cost-to-average-assets to 2.4%

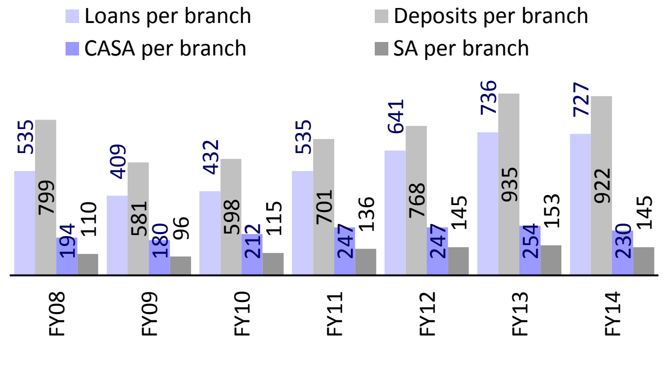
- DCBB's operating ratios are below industry average and it is on track to improve them. Enhanced efficiency should more than compensate for the cost of expansion. We expect opex-to-average-assets to decline to 2.4% and cost-to-income to decline to 56% by FY17.

Exhibit 36: DCBB has started expanding its network after four years (branches)



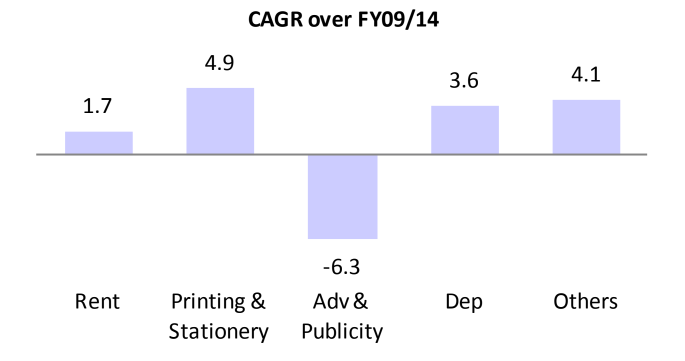
Source: Company, MOSL

Exhibit 37: Focus continues to be on improving productivity (INR m)



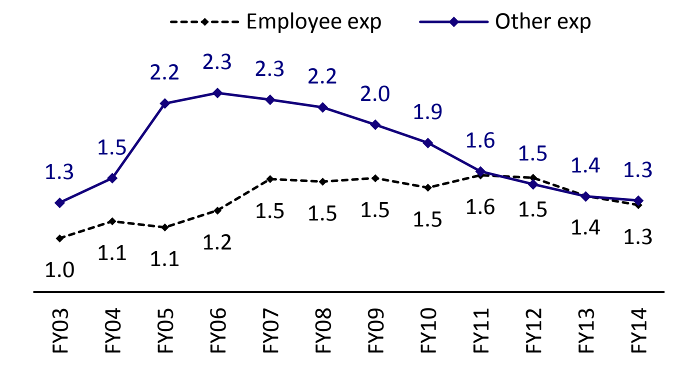
Source: Company, MOSL

Exhibit 38: Focus on cutting the flab (%)



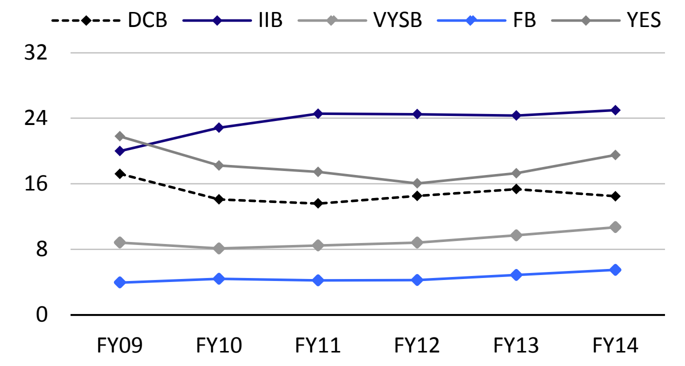
Source: Company, MOSL

Exhibit 39: Significant saving on overhead expenses (%)



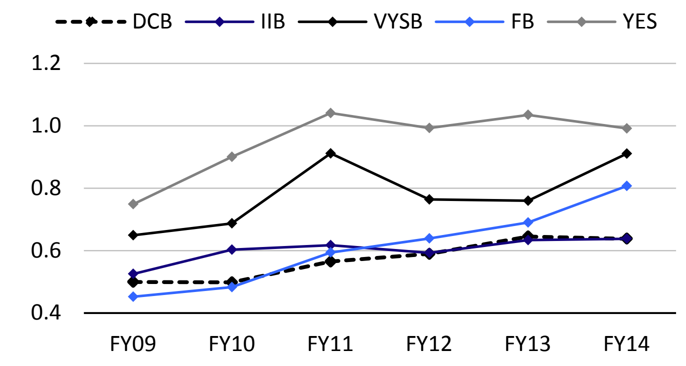
Source: Company, MOSL

Exhibit 40: Other opex per branch higher than old generation banks though lower than IIB and YES (INR m)



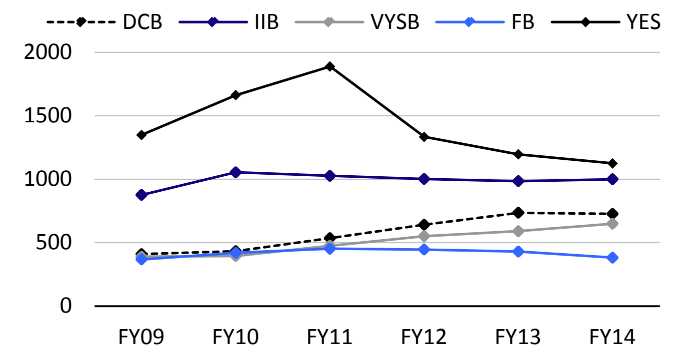
Source: MOSL, Company

Exhibit 41: Cost per employee among the lowest (INR m)



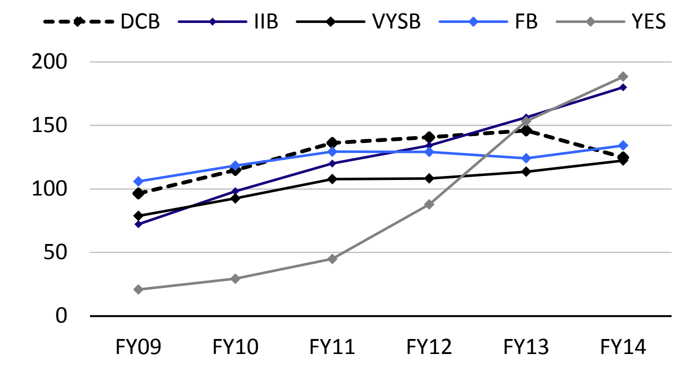
Source: MOSL, Company

Exhibit 42: Loans per branch steadily rising (INR m)



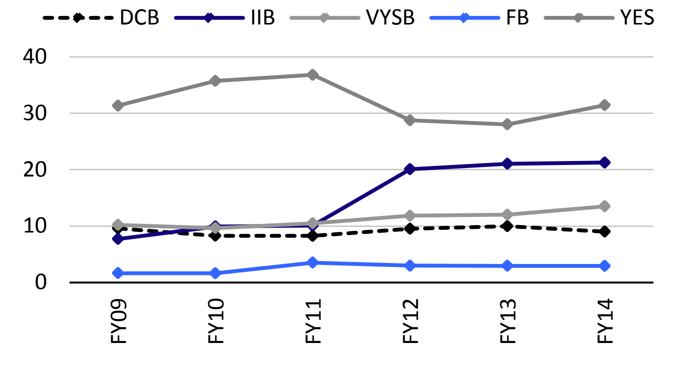
Source: Company, MOSL

Exhibit 43: SA per branch needs improvement (INR m)



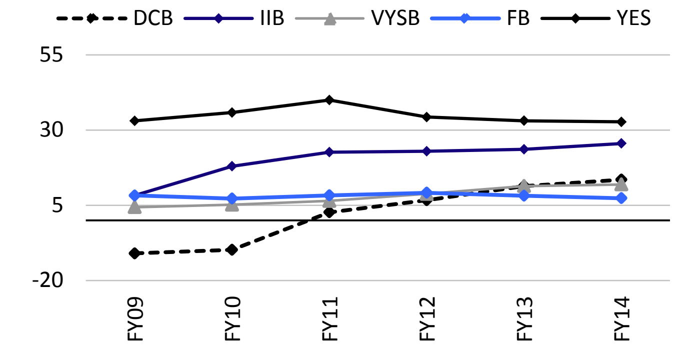
Source: Company, MOSL

Exhibit 44: Fee income generation significantly lower (INR m per branch)



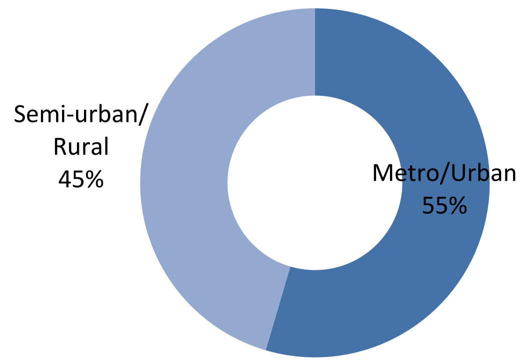
Source: MOSL, Company

Exhibit 45: Profitability per branch rising, led by operating leverage and better asset quality performance (INR m)



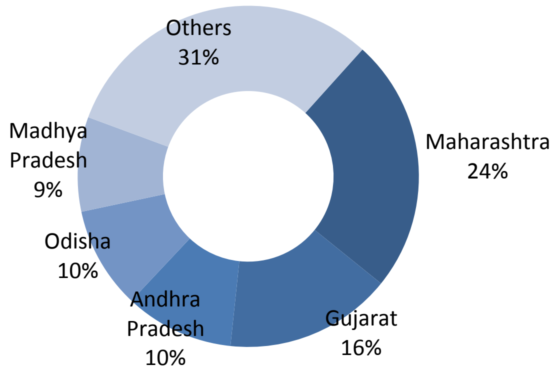
Source: MOSL, Company

Exhibit 46: Branch mix: focus to increase on Tier 2-6 centers…



Source: MOSL Company

Exhibit 47: High presence in central and western India



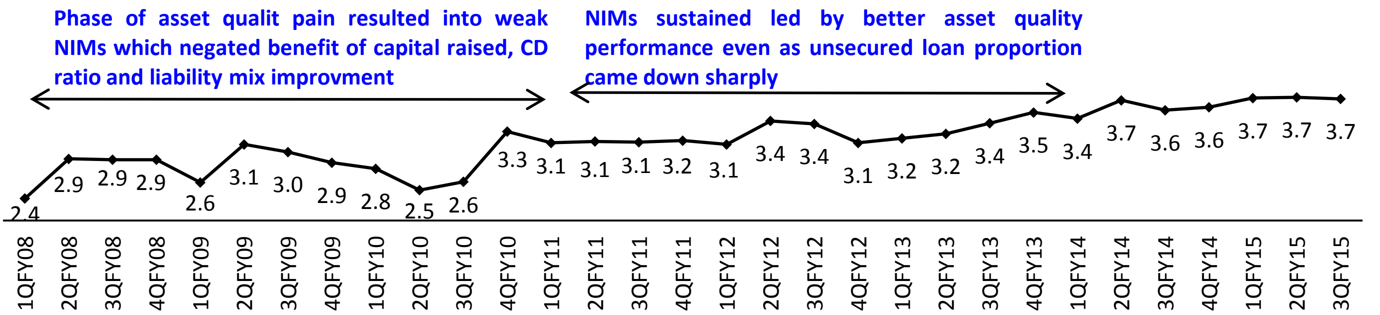
Source: MOSL Company

NIM expanded over FY10-14, helped by asset quality improvement

Expect DCBB to report sharp improvement in NIM from 2.8% in FY10 to 3.6%, partially helped by capital infusion in FY12

- NIM remained steady at 2.8-2.9% over FY08-10, despite (1) capital raised in 2HFY07, (2) 12% improvement in CD ratio, and (3) 10% increase in CASA ratio.
- Stress increased sharply, as GNPA worsened from 1.5% to 11%+ in 3QFY10 (sharp rise in interest income reversals), and winding up of high yielding unsecured retail assets (personal and CV/CE loans) impacted margins.
- However, the new management's initiatives on both the assets and liabilities side helped DCBB to report sharp improvement in NIM from 2.8% in FY10 to 3.6%. Margin expansion was partially helped by capital raised in FY12.
  Improvement in margins is commendable considering that the contribution of high yielding personal and CV/CE loans has declined sharply.

Exhibit 48: NIM has improved significantly compared to the previous cycle (%)



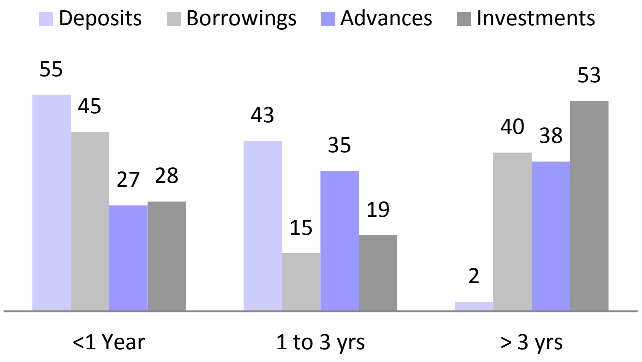
Source: Company, MOSL

To benefit from declining interest rates

54% of DCBB's liabilities are likely to be re-priced within a year as compared to 27% of assets; it stands to benefit in a falling interest rate environment

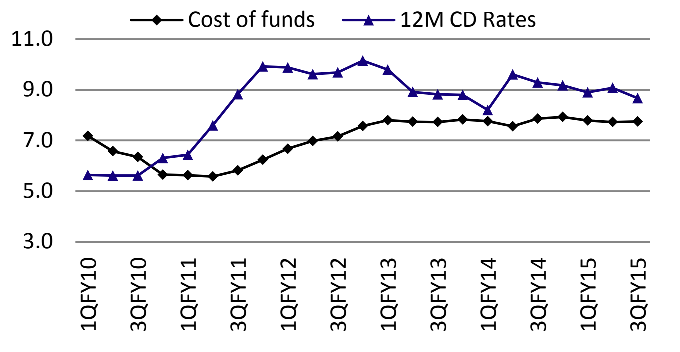
- The bank's asset-liability profile is such that it stands to benefit from fall in systemic interest rate. As at the end of FY14, 54% of its liabilities were expected to re-price within a year as compared to 27% of its assets. In a falling interest rate environment, liabilities would re-price faster and benefit margins.
- Further, expected rise in unsecured retail loans and increase in the share of SME loans would help the bank to improve yields and maintain margins.
- While we expect stable loan spreads over FY14-17, decline in investment spread and increase in leverage will lead some pressure on margins.

Exhibit 49: Asset-liability profile skewed towards short-term funding (years)



Source: Company, MOSL

Exhibit 50: Cost of funds highly correlated with 12-month CD rates (%)



Source: Company, MOSL

Conservatively we factor in 20bp moderation in margins

- Over the medium term (a) DCBB is poised to benefit from declining systemic interest rate (higher proportion of liabilities maturing within a year compared to loans), (b) augmentation of retail deposits to help contain cost of funds, and (c) growth in high yielding loans remains strong.
- Considering strong growth and increasing competition in LAP and SME business conservatively we have factored in 20bp decline in NIMs over FY15-17. However, there are levers (as discussed above) that could help NIM to improve, if they play out well.

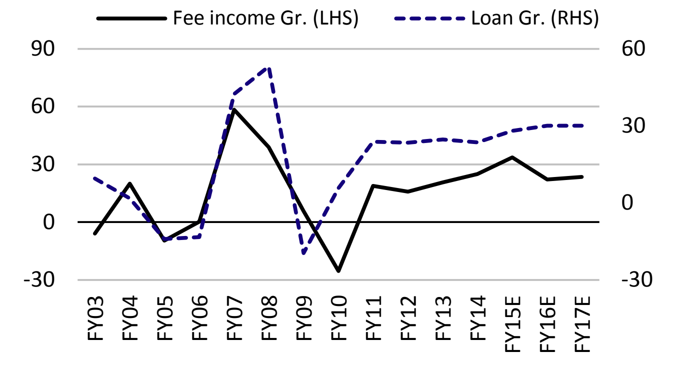
Fee income drag, now behind

- One of the drags on RoA was the sharp drop in fee income to average assets from 1.9-2% during FY07-08 to 90bp in FY14. Absence of high asset related fees, lower share of unsecured retail loans, and moderate growth in project lending had impacted growth.

Expect fee income to average assets to stabilize at 0.8% post a 50bp fall over FY08-14

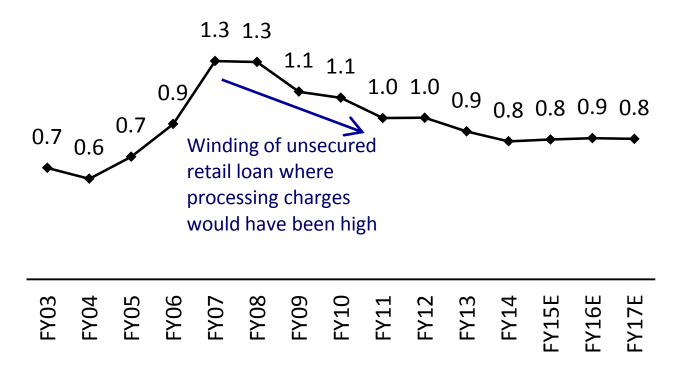
- Levers available for fee income are limited. However, increased focus on fee income, launch of new products, and higher cross selling would help fee income to grow in line with balance sheet growth. The sharp drag is behind, we believe.
- We factor fee income CAGR of ~23% over FY14-17. Fee income to average assets should sustain at current levels of 0.8-0.9%.

Exhibit 51: Fee income stabilizing; expect growth to resume (%)



Source: Company, MOSL

Exhibit 52: Share of fees to stabilize over FY14-17 (%)



Source: Company, MOSL

Core PPP growth of 35%+; Higher tax rate to drag down PAT growth

Core PPP and core PBT to grow at 35%+ CAGR over FY14-17

- We expect core PPP to grow at a CAGR of 37% over FY14-17, led by NIM expansion, higher loan growth, and benefit of operating leverage continuing. Asset quality should remain healthy, keeping credit cost low. We expect 35% CAGR in PBT over FY14-17.
- As the bank has become profitable and the benefit of accumulated losses is behind, effective tax rate would increase from 2HFY15 and impact earnings growth. We factor tax rate of 18% for FY15, 28% for FY16, and 30% for FY17. We expect earnings CAGR of 20% over FY14-17. RoA would be 1.2% and RoE to improve to ~14% by FY17 (despite full tax rate and capital raising)

Exhibit 53: Core income growth to improve (YoY growth, %)

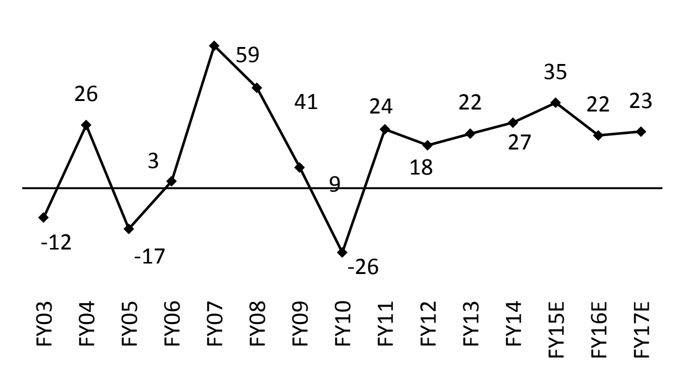


Exhibit 54: Core PPP growth to sustain at 35% (YoY growth, %)

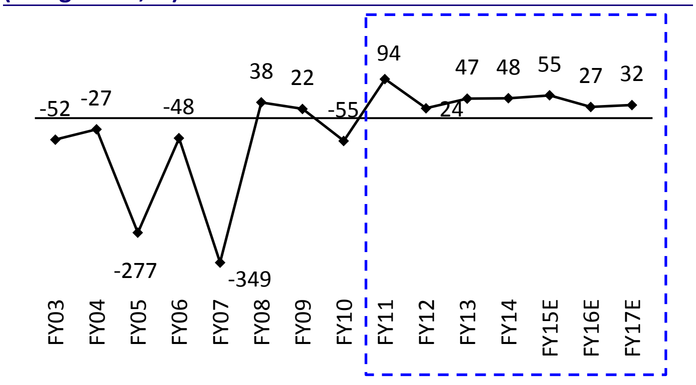
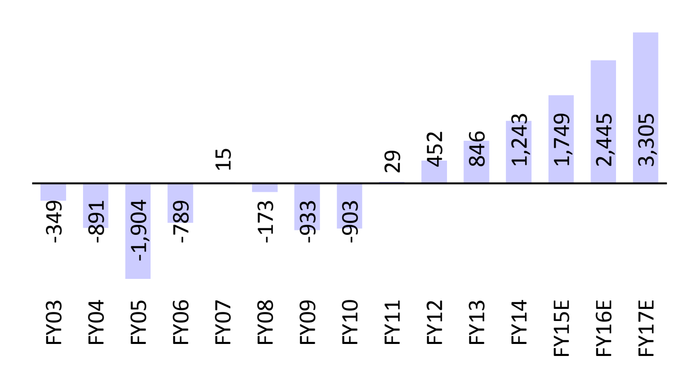
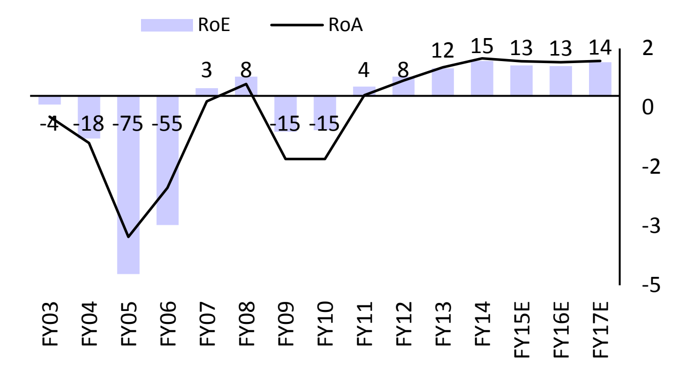


Exhibit 55: Core PBT growth to accelerate as credit cost remains contained (INR m)



Source: MOSL, Company

Exhibit 56: Return ratios to improve (%)



Source: MOSL, Company

Exhibit 57: Dupont – Steady improvement in core profitability; however, full tax rate to keep return ratios stable

% of average assets	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net interest Income	**2.71**	**2.92**	**2.35**	**2.79**	**2.83**	**2.85**	**3.04**	**3.52**	**3.45**	**3.38**
Fee income	1.32	1.14	1.10	0.98	0.98	0.90	0.84	0.85	0.85	0.85
Fees to core income (%)	32.7	28.0	31.9	25.9	25.7	23.9	21.5	19.35	19.84	20.10
Core Income	**4.02**	**4.05**	**3.45**	**3.77**	**3.81**	**3.75**	**3.88**	**4.37**	**4.31**	**4.23**
Operating expenses	**3.71**	**3.58**	**3.32**	**3.18**	**3.04**	**2.76**	**2.64**	**2.73**	**2.62**	**2.46**
Cost to core income (%)	92.1	88.3	96.4	84.3	79.8	73.7	68.0	62.5	61.0	58.3
Employees	1.51	1.54	1.46	1.57	1.55	1.38	1.30	1.36	1.32	1.26
Emp cost to Opex (%)	40.8	43.1	43.8	49.4	51.0	50.1	49.2	49.7	50.2	51.0
Others	2.19	2.03	1.87	1.61	1.49	1.38	1.34	1.37	1.31	1.21
Core PPP	**0.32**	**0.47**	**0.12**	**0.59**	**0.77**	**0.99**	**1.24**	**1.64**	**1.68**	**1.76**
Trading and others	1.39	0.64	0.67	0.68	0.27	0.28	0.31	0.32	0.33	0.32
Operating profits	**1.71**	**1.11**	**0.80**	**1.27**	**1.04**	**1.26**	**1.55**	**1.96**	**2.01**	**2.08**
Provisions	1.14	2.39	2.00	0.84	0.36	0.24	0.30	0.52	0.41	0.39
NPA	1.09	2.17	1.88	0.69	0.30	0.18	0.30	0.45	0.41	0.39
PBT	**0.56**	**-1.28**	**-1.20**	**0.43**	**0.68**	**1.02**	**1.25**	**1.44**	**1.60**	**1.69**
Tax	-0.03	0.02	0.09	0.12	0.00	0.00	0.00	0.26	0.45	0.51
Tax rate (%)	-6.1	-1.7	-7.8	26.7	0.1	0.0	0.0	18.0	28.0	30.0
ROAA (%)	**0.60**	**-1.30**	**-1.30**	**0.32**	**0.68**	**1.02**	**1.25**	**1.18**	**1.15**	**1.19**
Leverage (x)	13.6	11.6	11.2	12.3	11.8	11.4	11.8	10.84	10.86	11.94
ROAE (%)	**8.13**	**-15.13**	**-14.54**	**3.89**	**8.06**	**11.66**	**14.70**	**12.79**	**12.53**	**14.15**

Source: Company, MOSL

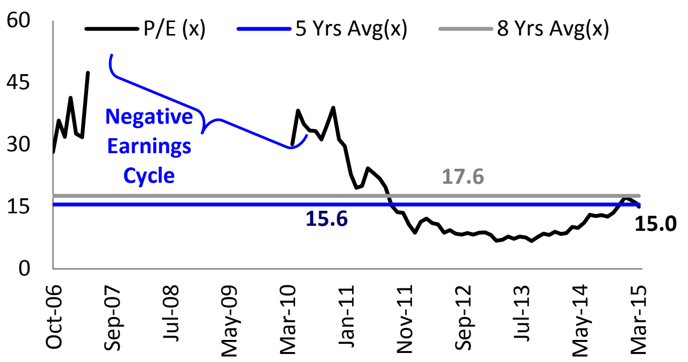
Initiating coverage with a target price of INR155

Productivity gains, improvement in return ratios to drive re-rating

Consistent improvement in core operating parameters, coupled with strong growth and asset quality, would continue the re-rating process

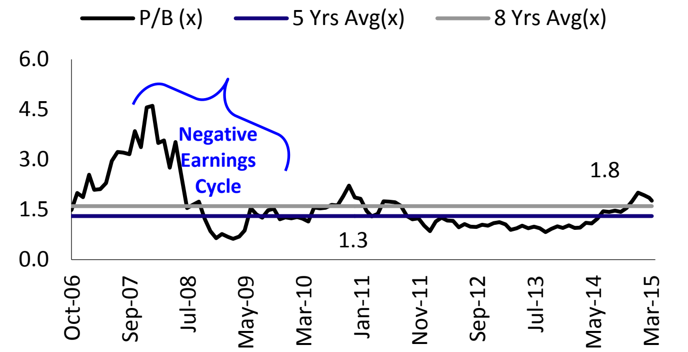
- **Since the management change, DCBB's core operating parameters have improved consistently. Pre-tax RoA has increased by ~250bp.**
- **We expect productivity gains to continue accruing, led by higher proportion of branches in urban/metropolitan regions, investment in technology, increasing footprint in semi-urban and rural areas, and rising economic growth.**
- **Consistent improvement in core operating parameters, coupled with strong growth and asset quality, would lead to continued re-rating. Buy with a target price of INR155 (46% upside).**

Exhibit 58: One-year forward P/E



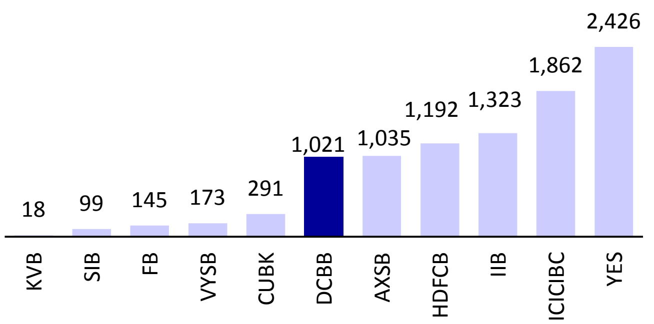
Source: Company, MOSL

Exhibit 59: One-year forward P/B



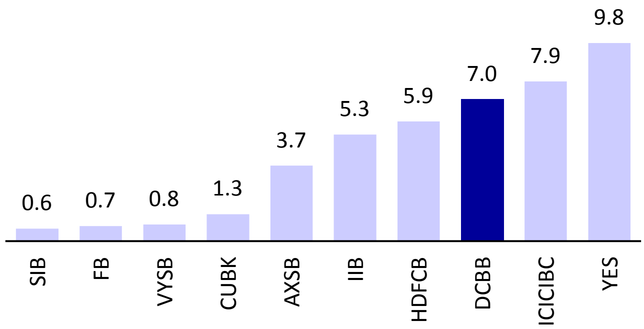
Source: Company, MOSL

Exhibit 60: Assets per branch (INR m)



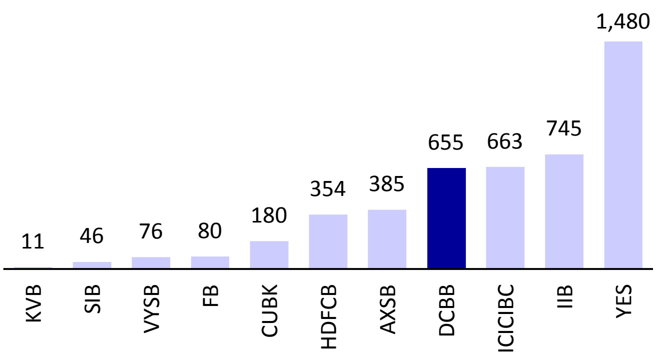
Source: Company, MOSL

Exhibit 61: Opex per branch (INR m)



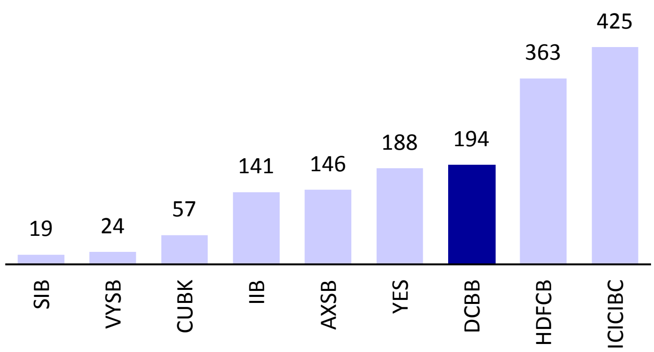
Source: Company, MOSL

Exhibit 62: Loans per branch (INR m)



Source: MOSL, Company

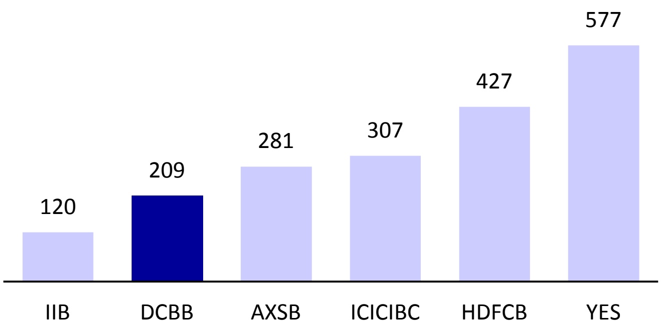
Exhibit 63: CASA per branch (INR m)



Source: MOSL, Company

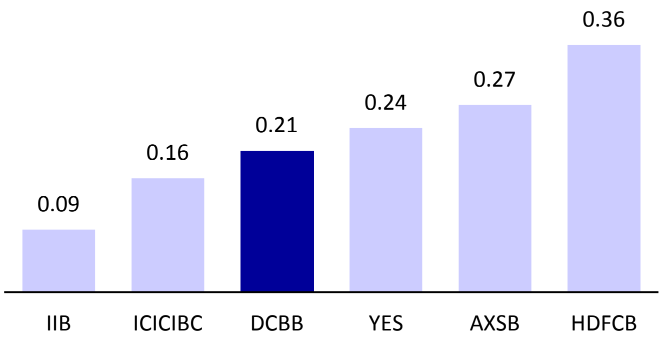
Comparison with peer banks (when they had ~150 branches) – DCBB undervalued on most parameters

Exhibit 64: Market capitalization per branch (INR m)



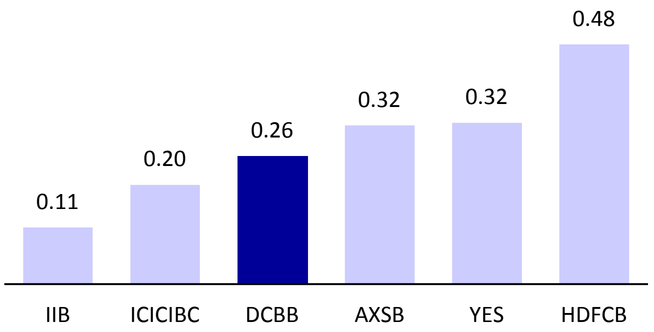
Source: Company, MOSL

Exhibit 65: Market capitalization to assets (x)



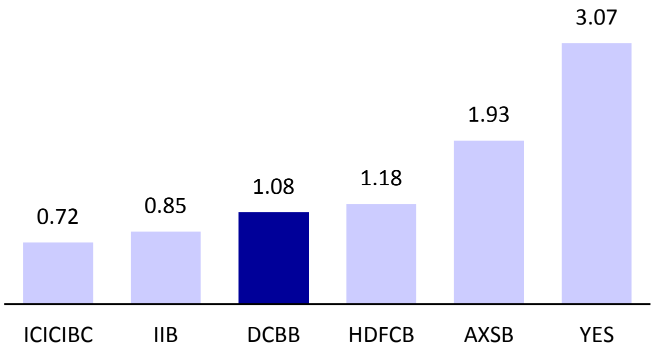
Source: Company, MOSL

Exhibit 66: Market capitalization to deposits (x)



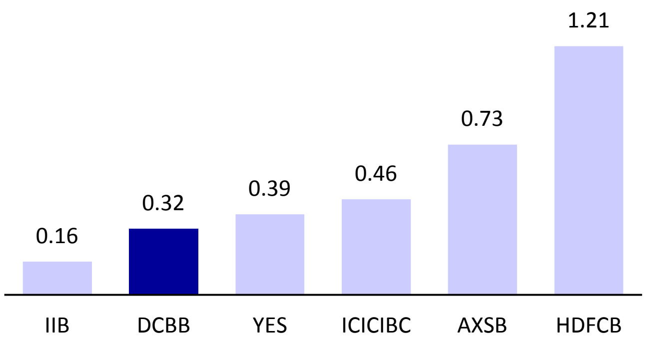
Source: MOSL, Company

Exhibit 67: Market capitalization to CASA (x)



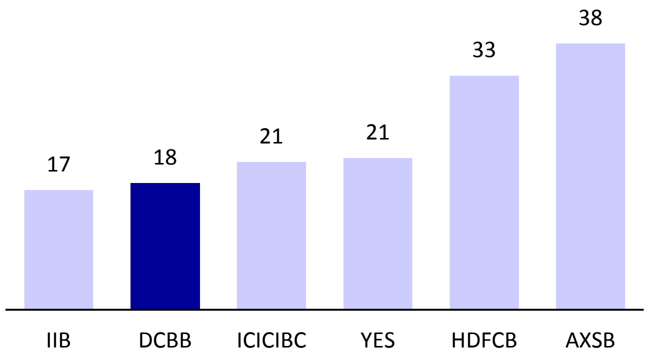
Source: MOSL, Company

Exhibit 68: Market capitalization to loans (x)



Source: Company, MOSL

Exhibit 69: Market capitalization to total income (x)



Source: Company, MOSL

Financials and valuations

Income Statement								(INR Million)
Y/E March	**2010**	**2011**	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**
Interest Income	4,594	5,363	7,170	9,161	11,283	14,260	17,305	21,469
Interest Expense	3,174	3,471	4,893	6,317	7,599	9,206	11,178	13,936
Net Interest Income	**1,420**	**1,891**	**2,277**	**2,844**	**3,684**	**5,055**	**6,127**	**7,534**
Change (%)	-28.0	33.2	20.4	24.9	29.5	37.2	21.2	23.0
Non Interest Income	1,071	1,121	1,004	1,170	1,387	1,673	2,103	2,609
Net Income	**2,491**	**3,012**	**3,281**	**4,014**	**5,071**	**6,728**	**8,229**	**10,143**
Change (%)	-21.5	20.9	8.9	22.3	26.3	32.7	22.3	23.2
Operating Expenses	2,008	2,152	2,443	2,753	3,191	3,916	4,660	5,499
Pre Provision Profits	**483**	**861**	**838**	**1,261**	**1,880**	**2,812**	**3,569**	**4,643**
Change (%)	-35.9	78.3	-2.6	50.5	49.0	49.6	26.9	30.1
Provisions (excl tax)	1,210	568	287	241	366	748	724	864
PBT	**-727**	**293**	**551**	**1,021**	**1,514**	**2,064**	**2,845**	**3,780**
Tax	57	78	0	0	0	371	797	1,134
Tax Rate (%)	-7.8	26.7	0.1	0.0	0.0	18.0	28.0	30.0
PAT	**-785**	**214**	**551**	**1,021**	**1,514**	**1,692**	**2,049**	**2,646**
Change (%)	-10.9	-127.3	157.0	85.4	48.3	11.8	21.1	29.2
Core PPP*	**307**	**597**	**739**	**1,086**	**1,609**	**2,497**	**3,169**	**4,168**
Change (%)	-55.2	94.3	23.7	47.1	48.1	55.2	26.9	31.5

*Core PPP is (NII+Fee income-Opex)

Balance Sheet								(INR Million)
Y/E March	**2010**	**2011**	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**
Equity Share Capital	2,000	2,002	2,407	2,501	2,503	2,808	2,808	2,808
Reserves & Surplus	3,990	4,185	6,179	7,499	9,007	12,734	14,623	17,212
Net Worth	**5,990**	**6,187**	**8,585**	**10,000**	**11,510**	**15,542**	**17,430**	**20,019**
Deposits	**47,873**	**56,102**	**63,356**	**83,638**	**103,252**	**126,999**	**161,924**	**207,263**
Change (%)	3.0	17.2	12.9	32.0	23.5	23.0	27.5	28.0
of which CASA Dep	**16,928**	**19,755**	**20,347**	**22,716**	**25,813**	**30,496**	**36,043**	**42,618**
Change (%)	17.5	16.7	3.0	11.6	13.6	18.1	18.2	18.2
Borrowings	5,056	8,635	11,263	15,286	8,631	8,110	10,007	12,316
Other Liabilities & Prov.	2,447	3,205	3,565	3,863	5,839	7,006	8,057	9,266
Total Liabilities	**61,367**	**74,129**	**86,768**	**112,788**	**129,231**	**157,658**	**197,418**	**248,864**
Current Assets	3,323	4,871	4,566	8,833	6,896	8,086	10,070	13,395
Investments	**20,179**	**22,950**	**25,178**	**33,587**	**36,342**	**40,703**	**46,809**	**53,830**
Change (%)	24.4	13.7	9.7	33.4	8.2	12.0	15.0	15.0
Loans	**34,597**	**42,817**	**52,844**	**65,861**	**81,402**	**104,194**	**135,453**	**176,089**
Change (%)	5.7	23.8	23.4	24.6	23.6	28.0	30.0	30.0
Fixed Assets	1,358	1,275	1,846	2,394	2,386	2,469	2,551	2,634
Other Assets	1,909	2,215	2,335	2,114	2,205	2,205	2,536	2,916
Total Assets	**61,367**	**74,129**	**86,768**	**112,788**	**129,231**	**157,658**	**197,418**	**248,864**

ASSET QUALITY								
GNPA (INR M)	3,192	2,636	2,418	2,150	1,385	1,952	2,555	3,263
NNPA (INR M)	1,076	412	302	491	740	1,021	1,375	1,732
GNPA Ratio	8.7	5.9	4.4	3.2	1.7	1.9	1.9	1.8
NNPA Ratio	3.1	1.0	0.6	0.7	0.9	1.0	1.0	1.0
PCR (Excl Tech. write off)	66.3	84.4	87.5	77.1	46.5	47.7	46.2	46.9

E: MOSt Estimates

Financials and valuations

Ratios								
Y/E March	**2010**	**2011**	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**
Spreads Analysis (%)								
Avg. Yield-Earning Assets	**8.5**	**8.8**	**9.9**	**10.0**	**10.1**	**10.7**	**10.4**	**10.2**
Avg. Yield on loans	10.7	10.4	11.2	12.0	11.8	11.8	11.7	11.4
Avg. Yield on Investments	5.2	6.1	7.2	6.7	7.0	7.3	7.1	6.8
Avg. Cost-Int. Bear. Liabilities	**6.1**	**5.9**	**7.0**	**7.3**	**7.2**	**7.5**	**7.3**	**7.1**
Avg. Cost of Deposits	6.0	5.6	6.8	7.3	7.1	7.0	6.8	6.7
Interest Spread	**2.4**	**2.9**	**2.9**	**2.7**	**2.9**	**3.2**	**3.1**	**3.1**
Net Interest Margin	**2.6**	**3.1**	**3.1**	**3.1**	**3.3**	**3.8**	**3.7**	**3.6**
Profitability Ratios (%)								
RoE	-14.5	3.9	8.1	11.7	14.7	12.8	12.5	14.2
RoA	-1.3	0.3	0.7	1.0	1.3	1.2	1.2	1.2
Int. Expense/Int.Income	69.1	64.7	68.2	69.0	67.3	64.6	64.6	64.9
Fee Income/Net Income	93.0	91.3	97.0	95.6	94.7	95.3	95.1	95.3
Non Int. Inc./Net Income	43.0	37.2	30.6	29.2	27.3	24.9	25.5	25.7
Efficiency Ratios (%)								
Cost/Income*	86.8	78.0	77.2	71.0	65.8	60.7	59.0	56.3
Empl. Cost/Op. Exps.	43.8	49.4	51.0	50.1	49.2	49.7	50.2	51.0
Busi. per Empl. (INR m)	67.6	55.1	68.3	78.1	79.4	90.7	107.3	129.4
NP per Empl. (INR lac)	-4.9	1.0	2.7	4.6	5.6	5.9	6.8	8.4
* ex treasury								
Asset-Liability Profile (%)								
Loans/Deposit Ratio	72.3	76.3	83.4	78.7	78.8	82.0	83.7	85.0
CASA Ratio	35.4	35.2	32.1	27.2	25.0	24.0	22.3	20.6
Investment/Deposit Ratio	33.0	31.2	31.9	29.1	27.2	27.0	25.0	24.0
G-Sec/Investment Ratio	78.2	76.3	80.3	72.4	77.2	84.2	86.5	92.4
CAR	14.9	13.3	15.4	13.6	13.7	15.3	13.3	12.0
Tier 1	*11.9*	*11.1*	*13.8*	*12.6*	*12.9*	*14.5*	*13.0*	*11.7*

Valuations								
Book Value (INR)	**27.1**	**28.2**	**33.4**	**38.5**	**45.1**	**55.2**	**62.1**	**71.3**
Change (%)	-12.3	3.8	18.7	15.1	17.3	22.3	12.6	14.9
Price-BV (x)	3.9	3.8	3.2	2.8	2.3	1.9	1.7	1.5
Adjusted BV (INR)	**23.4**	**26.7**	**32.6**	**37.1**	**43.0**	**52.6**	**58.7**	**67.0**
Price-ABV (x)	4.5	4.0	3.3	2.9	2.5	2.0	1.8	1.6
EPS (INR)	**-3.9**	**1.1**	**2.3**	**4.1**	**6.0**	**6.0**	**7.3**	**9.4**
Change (%)	-10.9	-127.3	157.0	85.4	48.3	11.8	21.1	29.2
Price-Earnings (x)	-27.0	99.0	46.3	26.0	17.5	17.6	14.5	11.2
Dividend Per Share (INR)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

E: MOSt Estimates

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