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# DCB Bank

# Well-positioned for the next growth phase

| CMP | Target Price |
|---|---|
| Rs112 | Rs140 (▪) |
| **Rating** | **Upside** |
| BUY (▪) | 25% |

**We initiate coverage on DCB Bank with a Buy rating and a target of Rs140. We expect its prudent business growth strategy, focused network expansion and superior asset quality to drive 1.2% ROA (post tax) over FY15-17E. With a proven management team and high capital adequacy, the bank is well positioned to exploit profitable business opportunities in its next growth phase.**

- **Sound and profitable business strategy.** Over FY10-14, DCB Bank's management shifted its focus to secured lending across diverse segments, while maintaining a consistently large share of retail deposits (~81%). This strategy paid off with improved credit quality, expanded risk-adjusted NIMs and better profitability as well as capital adequacy. Following up on this strategy, we estimate a 28% CAGR in business over FY14-17E, fuelled by mid-corporate, SME, agri-business and priority sector lending. The bank's high secured loan exposure entails low overall risk weights in the computation of capital adequacy, thereby reducing the strain on tier-1 capital for asset growth
- **Well-planned network expansion to drive business growth.** To compete with larger banks and establish itself, the bank's distribution strategy is focused on tier II-VI centres in Odisha, Madhya Pradesh, Chhatisgarh and Rajasthan. This is likely to propel advances growth in chosen segments of MSME and agri business. Additionally, as seen in our state-wise analysis of CASA distribution, the bank has strategically planned its branch expansion in states with good potential for CASA mobilization. As the branch expansion entails low-cost structures, it is likely to aid faster breakeven and better productivity
- **Relentless asset quality focus to support profitability.** With continuous monitoring, robust credit appraisal and limited exposure to consortium lending and troubled segments, the bank's asset quality is one of the best in the sector. Over time, the bank has also reduced its concentration risks, both in advances and deposits. The management's track record in managing asset quality is commendable, especially in the difficult macroeconomic environment seen over FY10-14. Given this backdrop and a likely pick-up in economic activity, we expect stable credit costs and asset quality to sustain over FY15-17E, driving further profitability
- **Premium valuations likely to sustain on improved fundamentals.** We expect robust profitability (1.2% RoA post-tax) over FY15-17E, led by the bank's prudent business growth strategy, focused network expansion and superior asset quality. We initiate coverage with a Buy rating, and expect the stock to sustain its premium valuations led by stronger business growth, high asset quality and greater capital adequacy ahead. Our target price of Rs140 is based on the two-stage dividend-discount model (CoE: 15.9%; beta: 1.2; Rf: 7.5%). **Risks:** Change in management, sharp rise in credit costs due to sluggish economic recovery, irrational competition from large banks

### Financial Snapshot (Standalone)

| (Rs mn) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Net income | 4,014 | 5,071 | 6,655 | 8,078 | 10,524 |
| Net profit | 1,021 | 1,514 | 1,734 | 1,919 | 2,935 |
| EPS (Rs) | 4.0 | 6.0 | 6.2 | 6.8 | 10.4 |
| ABV (Rs) | 37.7 | 42.6 | 53.1 | 59.5 | 69.2 |
| RoA (%) | 1.0 | 1.3 | 1.2 | 1.1 | 1.3 |
| RoE (%) | 10.9 | 14.0 | 12.7 | 11.5 | 15.3 |
| PE (x) | 27.9 | 18.8 | 18.2 | 16.5 | 10.9 |

*Source: Company, Emkay Research*

| Change in Estimates | |
|---|---|
| EPS Chg FY15E/FY16E (%) | NA |
| Target Price change (%) | NA |
| Previous Reco | NA |

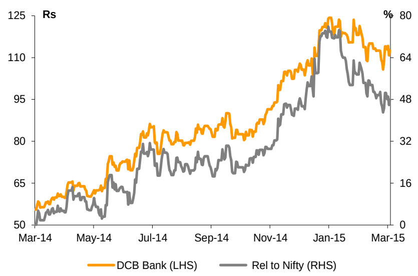
| Emkay vs Consensus | | |
|---|---|---|
| | EPS Estimates | |
| | FY15E | FY16E |
| Emkay | 6.2 | 6.8 |
| Consensus | 6.3 | 7.2 |
| Mean Consensus TP | | Rs 137 |

| Stock Details | |
|---|---|
| Bloomberg Code | DCBB IN |
| Face Value (Rs) | 10 |
| Shares outstanding (mn) | 282 |
| 52 Week H/L | 127 / 54 |
| M Cap (Rs bn/USD bn) | 32 / 0.51 |
| Daily Avg Volume (nos.) | 18,04,257 |
| Daily Avg Turnover (US$ mn) | 3.3 |

| Shareholding Pattern Dec '14 | |
|---|---|
| Promoters | 16.4% |
| FIIs | 15.5% |
| DIIs | 24.3% |
| Public | 43.8% |

| Price Performance | | | | |
|---|---|---|---|---|
| (%) | 1M | 3M | 6M | 12M |
| Absolute | (4) | 6 | 38 | 105 |
| Rel. to Nifty | 1 | 3 | 26 | 48 |

**Relative price chart**




*Source: Bloomberg*

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# Sound and profitable business strategy

Over FY10-14, DCB Bank's management shifted its focus to secured lending across diverse segments, while maintaining a consistently large share of retail deposits (~81%). This strategy has resulted in improved credit quality, expanded risk-adjusted NIMs, and better profitability as well as capital adequacy. Following up on this strategy, we estimate a 28% CAGR in business over FY14-17E, fuelled by mid-corporate, SME, agri-business and priority sector lending. The bank's high secured loan exposure entails low overall risk weights in the computation of capital adequacy, thereby reducing the strain on tier-1 capital for asset growth ahead.

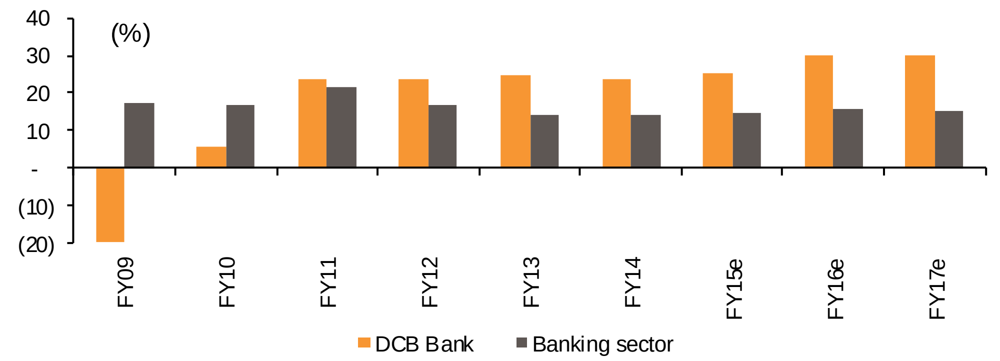
## Business-growth focus on secured assets and retail liabilities

In FY09, the bank's management team, led by its MD, Mr Murali Natrajan, decided to adopt a restructuring and risk-aversion strategy. This led to the bank considerably shifting its business focus. On the assets front, the management decided to focus on credit growth by diversifying secured assets and reducing exposure to unsecured/risky assets. On the liabilities front, it reduced dependence on wholesale borrowings by increasing the share of retail liabilities in total borrowings (i.e. a higher incremental share of CASA and retail term deposits).

The bank's advances composition has undergone a significant transformation since FY09. The diversification strategy led to a shift in focus to the mortgage, mid-corporate, small & medium enterprises (SME), farm and priority segments. During this restructuring (FY08-10), the bank's advances de-grew by 9.8% CAGR as compared to the 19.2% CAGR of the banking sector. Subsequently, as DCB Bank's balance-sheet stability returned, its advances growth at 23.9% CAGR (FY10-14) outpaced the banking sector's 17% CAGR during the same period. In 9MFY15, the bank's advances grew 28.9% yoy compared to the banking sector's 10.5% yoy.

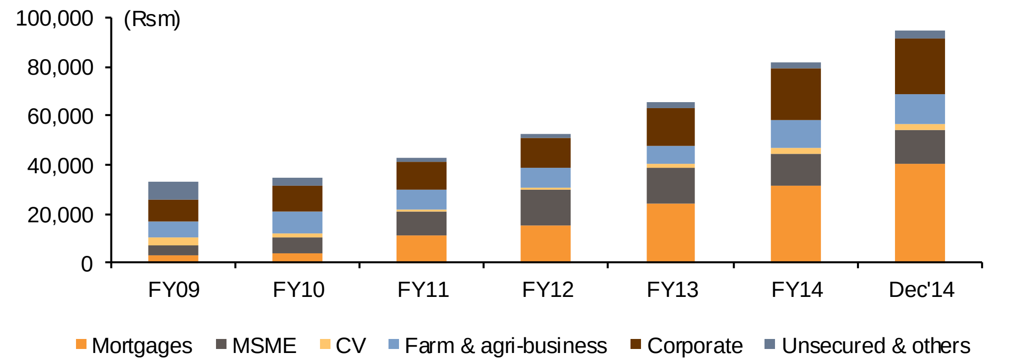
To push asset growth, the bank introduced products such as warehouse-based commodity financing (focused on priority-sector lending) and cash management and trade-finance products to mid-corporate/SME customers. In the last two years, the bank has sharpened its focus on agri and inclusive banking by introducing new banking products such as crop and land development loans to farmers, tractor loans, loans against gold jewellery, warehouse-construction loans and financing against warehouse receipts. Working-capital loans for agri-business and SMEs were also added to the bouquet of loan products.

**Exhibit 1: DCB Bank's advances growth vs. the banking sector**




*Source: Company, Emkay Research*

**Exhibit 2: DCB Bank's advances composition**



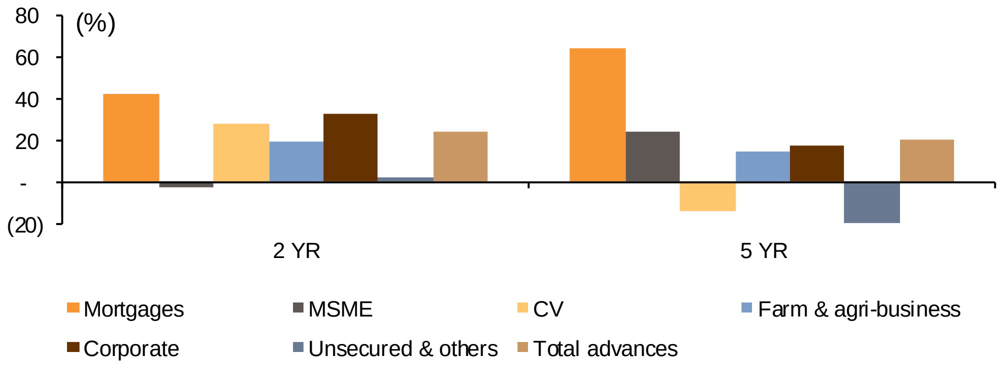

*Source: Company, Emkay Research*

**Exhibit 3: DCB Bank's advances strategy**

| Segment | Outlook | Share % | | | | CAGR | |
|---|---|---|---|---|---|---|---|
| | | FY09 | FY12 | FY14 | Dec'14 | 2 YR | 5 YR |
| Mortgages | Robust improvement in mortgages, skewed towards LAP (65-70% now). Avg loan size is ~5m, with maximum loan size capped at Rs30m. In LAP, the bank's main focus is self-employed. The bank does not finance builders or large ticket loans. With higher competition, margins could remain sluggish, but high asset cover provides comfort on asset quality and growth. | 8.0 | 29.4 | 38.4 | 42.4 | 42.0 | 64.1 |
| MSME | Initiatives have been taken to de-risk the SME book by reducing ticket size to Rs30m from Rs60-70m. Accounts >Rs30m are closely monitored. Lending is largely exposed to customers with hard collateral, rather than inventories. The bank has well-established business relationships in major industrial clusters such as Ahmedabad, Ankleshwar, Aurangabad, Bengaluru, Bhuj, Delhi, Jodhpur, Kochi, Kolkata, Mumbai, Rajkot, and Surat. **These are likely to drive ~20-25% growth.** | 13.7 | 26.6 | 16.6 | 14.4 | -1.9 | 24.7 |
| CV | CV advances have declined sharply after significant delinquencies in FY09. After bringing about stability in CV asset quality, the bank increased focus on this segment in FY11, but initial focus was on existing customers so as to have better control on customer yields and asset quality. Now, the bank is slowly expanding its customer base to local delivery SCVs in Tier II - VI locations. Growth could be high, but would remain a small share of overall loans | 10.9 | 2.0 | 2.1 | 2.4 | 27.9 | -13.6 |
| Farm & agri-business | The product portfolio includes loans for farm equipment, dairy loan, loan against gold jewellery, warehouse construction, finance against warehouse receipts, crop loan and land development and agribusiness working capital loans. **Network expansion in tier-2/3 cities should aid ~18-20% CAGR over FY15-17e.** | 17.4 | 15.2 | 14.2 | 13.4 | 19.9 | 15.1 |
| Corporate | Largely mid-corporate lending (avg. ticket size of Rs180-200m), not concentrated in any sector. Due to the weak macro-environment, the bank exited loans that did not fit with its risk appetite by allowing some large ticket size exposures and risky ones to mature. **The bank aims to grow by ~15-20% every year, and add ~20-25 accounts every year.** | 28.5 | 22.6 | 25.7 | 23.7 | 32.4 | 17.6 |
| Unsecured & others | Unsecured advances have declined sharply after significant delinquencies in FY09. The bank has 100% provisions on unsecured retail, whose contribution to overall advances is negligible. **No near-term focus to grow this segment.** | 21.4 | 4.3 | 3.0 | 3.6 | 2.8 | -19.2 |
| **Total advances** | **25-30% CAGR likely over FY15-17e, with firm focus on profitability (NIM of 330bps or more) and quality (slippages below 1%).** | | | | | **24.1** | **20.0** |

*Source: Company, Emkay Research*

**Exhibit 4: Advances CAGR**



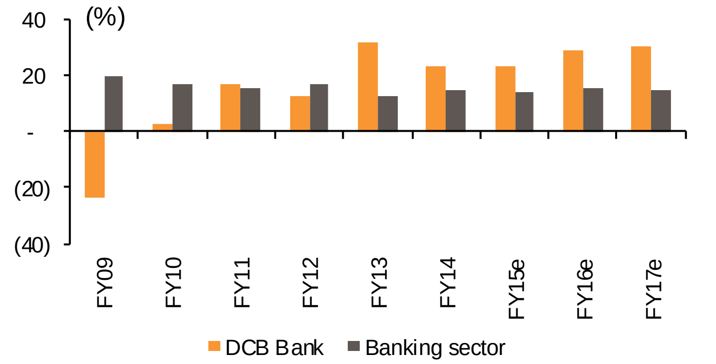

*Source: Company, Emkay Research*

Since FY09, DCB Bank's liabilities profile has gradually turned more towards retail than wholesale. The management reduced the bank's dependence on wholesale borrowings by increasing the proportion of retail liabilities in total borrowings, i.e., a higher incremental share of CASA and retail term deposits. Over FY08-10, as the management focused on balance-sheet stability, deposits growth contracted by a 11.2% negative CAGR as compared to the system's 18.6% CAGR. The shrinkage in deposits was largely led by wholesale deposits declining at a 48% CAGR. Remarkably, CASA and retail-term deposits registered CAGRs of 7.1% and 17.2% respectively over the same period. The bank also saw a sharp improvement in CASA share in total deposits, from 24.3% in FY08 to 35.4% in FY10.

As the bank's focus on growth returned after stability in overall operations, deposits growth expanded over FY10-14 at 21.2% CAGR compared to the 15.3% CAGR of the system. More importantly, the bank's percentage of retail deposits in total deposits rose from 51.9% in FY08 to 76.9% in FY14. The key contributor to this increase has been retail term deposits, whose percentage in term deposits increased from 38.4% to 72.2% over the same period. In Dec'14, the share of retail deposits in total deposits has further improved to 81.5%, with retail term deposits comprising a high 78.1% of total deposits.

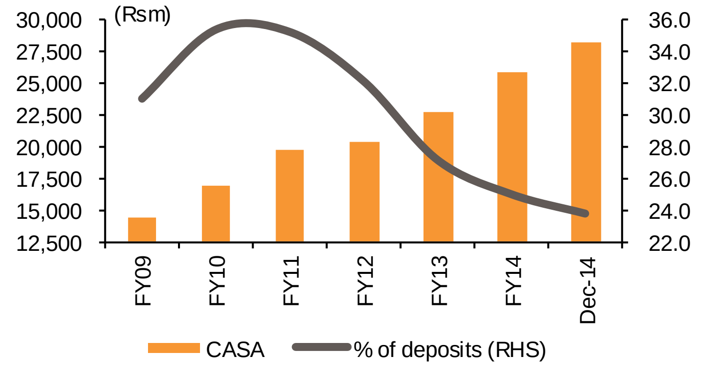
The bank's low-cost deposit (CASA) is largely constituted of retail, with the share of retail customers in CASA deposits averaging ~93.5% over FY08-14. This has been the primary reason for the steady decline in overall CASA share, from 31% in FY09 to 25% in FY14. As the bank is a very small operator in the sector or in consortiums, it is difficult for it to acquire large-ticket current accounts. Also, the management does not chase large-ticket current accounts as these are usually quite volatile, rendering it difficult to build a stable balance sheet. Hence, the bank prefers to focus on self-employed customers, who have current accounts of Rs0.3-0.5m. The retail focus on liabilities is also reflected in the improved percentage of savings deposits in CASA, from 53.5% in FY09 to 62.8% in FY14. In Dec'14, retail CASA comprised a high 92.5% of total deposits.

**Exhibit 5: DCB Bank's deposits growth has outpaced that of banking sector over FY13-14; likely to continue**



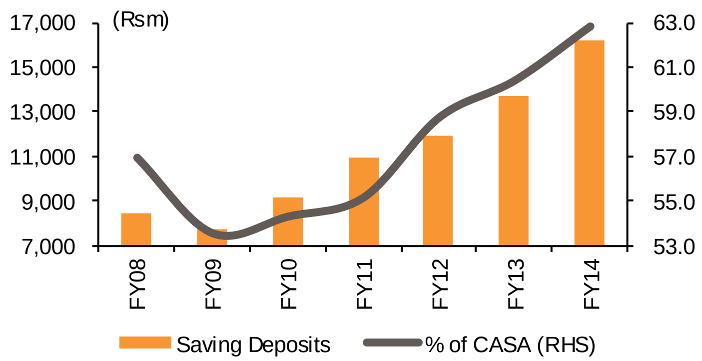

*Source: Company, Emkay Research*

**Exhibit 6: Despite falling share in total deposits, low-cost deposits have progressed steadily**



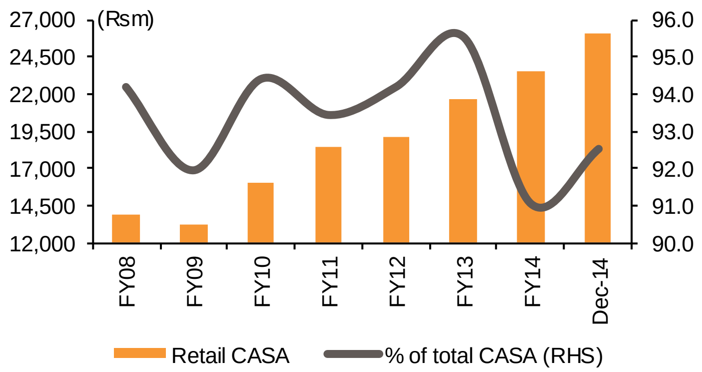

*Source: Company, Emkay Research*

**Exhibit 7: Savings deposits contribute majorly to CASA**



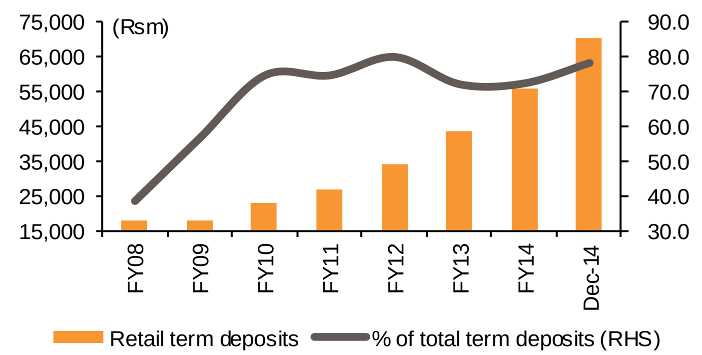

*Source: Company, Emkay Research*

**Exhibit 8: Retail deposits dominate CASA**



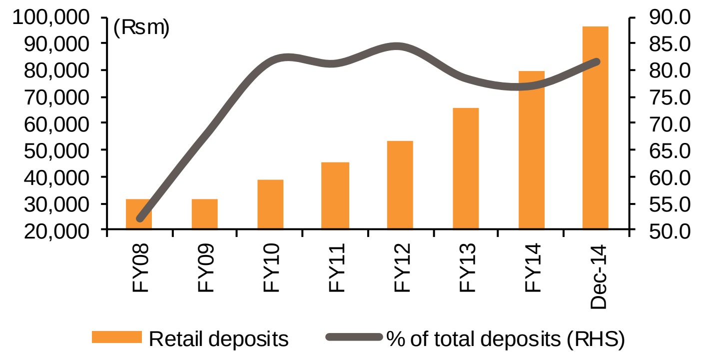

*Source: Company, Emkay Research*

**Exhibit 9: Retail comprises a high share of term deposits**




*Source: Company, Emkay Research*

**Exhibit 10: Retail comprises a high share of total deposits**




*Source: Company, Emkay Research*

Management's business-growth strategy of a more secured and less concentrated credit exposure coupled with a sound and sticky retail deposits franchise, has conferred remarkable results:

- **Improved credit quality –** Gross NPAs have declined from 8.8% in FY09 to 1.7% in FY10, with net NPAs sharply falling from 3.9% in FY09 to 0.9% in FY14. Additionally, fresh delinquencies declined from 10% of loans in FY09 to 1.2% in FY14, all the more remarkable in the difficult macroeconomic environment, which persisted over FY09-14. In Dec'14, while gross and net NPAs rose marginally to 1.9% and 1% of loans respectively, overall asset quality remained under control.
- **Better risk-adjusted NIMs –** Despite an increase in the share of secured loans (where asset yields are much lower), the bank's NIM inched up from 3.1% in FY09 to 3.2% in FY14. While this might seem to be a negligible increase, it is attractive if we take into consideration the sharp decrease in NPA provisions over the same period (411bps in FY09 to 33bps in FY14). In Dec'14, NIM (annualized) further improved to 3.5%, after adjusting for other interest income of Rs306m.
- **Sharp increase in profitability** – From losses and a negative RoA of 1.3% in FY09, the bank has seen a huge swing in profitability to 1.3% in FY14. In that period, the RoE has drastically improved from -14% to 14%. Despite providing for taxes in 9MFY15, it has maintained its RoA at 1.3%, thanks to the sharp improvement in core earnings.
- **Better capital adequacy from retained profits** – Capital adequacy has risen from 13.3% in FY09 to 13.6% in FY14, with tier-1 capital also up, from 11.5% to 12.8% in that period. The robust profitability (40.5% CAGR in pre-provisioning profit over FY10-14) has more than sufficed to meet the bank's prudent and conservative business growth. However, the bank has had two doses of capital infusion over FY10-14, mainly to reduce the promoter's exposure to comply with the RBI requirement. In Oct'14, the bank raised Rs2,500m, which has further bolstered the bank's capital adequacy to 14.4%, with tier-1 capital of 13.6%.

We expect a 28% CAGR in credit over FY15-17E, to be fuelled by mid-corporate, SME, agri-business and priority sector lending. The bank's high secured loan exposure entails low overall risk weights in the computation of capital adequacy, thereby reducing the strain on tier-1 capital for asset growth ahead.

Continuing with its liabilities strategy and a 24% CAGR in branch additions over FY12-14, CASA deposits are likely to outpace overall deposits growth over FY15-17. On an estimated 31% CAGR in CASA over FY14-17E, we expect its proportion in total deposits to improve from 25% in FY14 to 27% in FY17. We estimate an overall deposit CAGR of 27.7% in that period.

# Well-planned network expansion to drive business growth

To compete with larger banks and establish itself, the bank's distribution strategy is focused on tier II-VI centres in Odisha, Madhya Pradesh, Chhatisgarh and Rajasthan. This would propel advances growth in chosen segments of MSME and agri business. Additionally, as seen in our state-wise analysis on CASA distribution, the bank has strategically planned its branch expansion in states with good potential for CASA mobilization. As the branch expansion entails low-cost structures, it is likely to aid faster breakeven and better productivity.

## Focused network expansion in central and east India

With 145 branches at 94 locations, the bank has one of the smallest branch networks in the banking sector. However, it has adopted a well-thought-out expansion strategy to compete in the crowded banking marketplace and establish its niche presence.

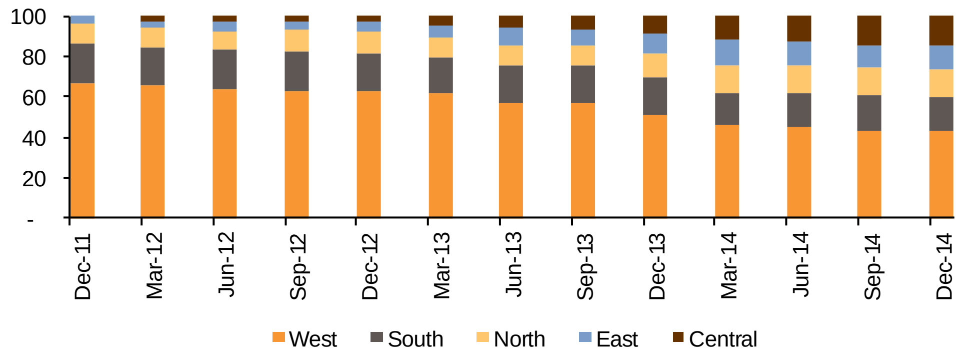
In the initial phase of consolidation (FY08-11), branch expansion had stalled as management placed emphasis on improving productivity at existing branches. Hence, only four branches were opened during this period. With the return to business stability, 50 branches were added over FY11-14. This has been fuelled by a cautious cluster-based approach to branch expansion, rather than a relentless expansion across areas within India.

The strategy for branch expansion is to concentrate on tier-II to tier-VI centres, where it is either the first or second private-sector bank to open a branch. The primary objectives of the new branch would be -

- Liabilities - generate CASA balances and retail term deposits through its branches and sales teams in the field
- Assets - cover more than 85-90% of the potential MSME market within the branch area
- Priority-sector lending (PSL) - achieve the RBI's targets without resorting to buyouts
- Productivity - low cost-to-income to achieve breakeven sooner than in metros/tier-I cities

At present, the bank's branch network is primarily concentrated in eight states: Maharashtra, Gujarat, Telangana, Orissa, Madhya Pradesh, Chhattisgarh, Punjab and Delhi. These states account for 79% of its branch network. In terms of regional concentration, 43% of its branches are in West India, 17% in South India, 14% in North India, 14% in Central India and 12% in East India.

**Exhibit 11: Achieving pan-Indian presence – lowering branch concentration in Western India**




*Source: Company, Emkay Research*

**Exhibit 12: DCB Bank's branches across India**

| | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total Branches** | **82** | **84** | **86** | **87** | **89** | **94** | **101** | **103** | **115** | **130** | **134** | **142** | **145** |
| Goa | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Gujarat | 16 | 16 | 16 | 16 | 17 | 18 | 19 | 19 | 19 | 20 | 20 | 21 | 22 |
| Maharashtra | 35 | 35 | 35 | 35 | 35 | 35 | 34 | 35 | 35 | 35 | 35 | 35 | 35 |
| Dadra & Nagar Haveli | | | | | | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Andhra Pradesh & Telangana | 10 | 10 | 10 | 10 | 10 | 10 | 12 | 12 | 13 | 13 | 14 | 15 | 15 |
| Karnataka | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Tamil Nadu | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 4 | 5 | 5 |
| Kerala | | | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Haryana | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 2 | 2 |
| New Delhi | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 7 | 7 |
| Rajasthan | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 5 | 5 | 5 | 5 | 5 |
| Punjab | - | - | - | 1 | 1 | 1 | 1 | 1 | 2 | 5 | 5 | 6 | 6 |
| Uttar Pradesh | - | - | - | - | - | 1 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Madhya Pradesh | - | 2 | 2 | 2 | 2 | 3 | 4 | 5 | 6 | 7 | 9 | 12 | 13 |
| Chhattisgarh | - | - | - | - | - | - | - | - | 2 | 6 | 6 | 6 | 6 |
| Orissa | - | - | 1 | 1 | 2 | 3 | 5 | 5 | 8 | 13 | 13 | 13 | 14 |
| West Bengal | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |

*Source: Company, Emkay Research*

To augment its business-growth strategy, the management has identified relevant areas to set up its "hub" branches, around which it would set up "spoke" branches. While the bank's first hub-and-spoke branch model took off in Gujarat, branches have been gradually added in states such as Odisha, Madhya Pradesh and Chhattisgarh, which are under-banked and open up large untapped potential of SME customers. Additionally, as seen in our state-wise analysis of CASA distribution, the bank has strategically planned its branch expansion in states with good potential for CASA mobilization.

**Exhibit 13: Hub-and-spoke branches across states**

| State | Hub branch | Spoke branches |
|---|---|---|
| Western Odisha | Bargarh | Dungaripali, Attabira, Redhakhol, Dharamgadh, Patangadh, Balangir |
| Madhya Pradesh | Itarsi | Piparia, Gadarwara, Mandideep, Ganj Basoda, Gotegaon, Karmeta, Nayakheda |
| Coastal & Southern Odisha | Bhubaneswar | Durgaprasad, Jagannathpur, Jarasingha, Raghunathpur, Surala Junction, Hinjilicut |
| Chhatisgarh | Kumhari | Berla, Bemetara, Baloda Bazar, Dongergaon, Kurra |

*Source: Company, Emkay Research*

The bank's key focus regions contribute largely to India's national domestic product. Business growth in its focused areas has been much faster than the national average. This is likely to augur well for its business growth plans ahead.

**Exhibit 14: State-wise distribution of deposits and credit**

| | | | Deposits | | | | Credit | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No. of reporting offices | | Amount (Rs bn) | Share in total deposits (%) | Amount (Rs bn) | Share in total deposits (%) | Amount (Rs bn) | Share in total credit (%) | Amount (Rs bn) | Share in total credit (%) | Credit / Deposit (%) | |
| **State** | **FY14** | **1HFY15** | **FY14** | | **1HFY15** | | **FY14** | | **1HFY15** | | **FY14** | **1HFY15** |
| Punjab | 5,283 | 5,530 | 2,305 | 3 | 2,373 | 3 | 1,812 | 3 | 1,762 | 3 | 78.6 | 74.3 |
| Rajasthan | 5,689 | 5,915 | 2,016 | 3 | 2,077 | 3 | 1,761 | 3 | 1,783 | 3 | 87.3 | 85.9 |
| Odisha | 3,858 | 4,004 | 1,659 | 2 | 1,759 | 2 | 732 | 1 | 688 | 1 | 44.1 | 39.1 |
| Chhattisgarh | 1,988 | 2,070 | 893 | 1 | 900 | 1 | 525 | 1 | 534 | 1 | 58.8 | 59.4 |
| Madhya Pradesh | 5,391 | 5,602 | 2,269 | 3 | 2,435 | 3 | 1,362 | 2 | 1,345 | 2 | 60.0 | 55.2 |
| Gujarat | 6,463 | 6,656 | 4,166 | 5 | 4,327 | 5 | 3,087 | 5 | 3,053 | 5 | 74.1 | 70.6 |
| Maharashtra | 10,640 | 10,897 | 20,525 | 26 | 19,628 | 24 | 18,131 | 29 | 17,552 | 29 | 88.3 | 89.4 |
| Andhra Pradesh | 9,526 | 10,016 | 4,431 | 6 | 4,585 | 6 | 4,893 | 8 | 4,961 | 8 | 110.4 | 108.2 |
| **All India** | **115,822** | **120,344** | **80,282** | **100** | **81,143** | **100** | **62,643** | **100** | **61,576** | **100** | **78.0** | **75.9** |

*Source: Company, Emkay Research*

**Exhibit 15: State-wise CAGR in credit and deposits**

| | 1HFY12 | | 1HFY15 | | CAGR (1HFY12-15) | |
|---|---|---|---|---|---|---|
| | Deposits | Credit | Deposits | Credit | Deposits | Credit |
| Punjab | 1,637 | 1,203 | 2,373 | 1,762 | 13.2 | 13.6 |
| Rajasthan | 1,394 | 1,225 | 2,077 | 1,783 | 14.2 | 13.3 |
| Odisha | 1,131 | 525 | 1,759 | 688 | 15.9 | 9.5 |
| Chhattisgarh | 611 | 304 | 900 | 534 | 13.8 | 20.6 |
| Madhya Pradesh | 1,540 | 873 | 2,435 | 1,345 | 16.5 | 15.5 |
| Gujarat | 2,834 | 1,845 | 4,327 | 3,053 | 15.1 | 18.3 |
| Maharashtra | 14,871 | 12,344 | 19,628 | 17,552 | 9.7 | 12.5 |
| Andhra Pradesh | 3,151 | 3,448 | 4,585 | 4,961 | 13.3 | 12.9 |
| **All India** | **57,046** | **42,453** | **81,143** | **61,576** | **12.5** | **13.2** |

*Source: RBI*

**Exhibit 16: State-wise low-cost deposits (CASA)**

| | CASA (% of total deposits) | | | CAGR | |
|---|---|---|---|---|---|
| | FY03 | FY08 | FY13 | 5yr | 10yr |
| Punjab | 42.3 | 45.2 | 43.2 | 13.8 | 12.7 |
| Rajasthan | 44.3 | 47.1 | 45.9 | 18.7 | 16.8 |
| Odisha | 45.5 | 44.6 | 43.8 | 21.1 | 19.7 |
| Chhattisgarh | 48.1 | 51.4 | 47.3 | 19.7 | 18.7 |
| Madhya Pradesh | 41.1 | 47.1 | 43.4 | 17.6 | 16.9 |
| Gujarat | 35.4 | 39.4 | 36.2 | 16.9 | 15.8 |
| Maharashtra | 30.4 | 32.9 | 24.7 | 9.1 | 16.3 |
| Andhra Pradesh | 36.6 | 39.5 | 37.2 | 15.7 | 16.8 |
| **All India** | **38.1** | **38.7** | **36.2** | **15.1** | **16.0** |

*Source: RBI*

**Exhibit 17: State-wise NDP (%)**

| Year | Andhra Pradesh | Gujarat | Maharashtra | Delhi | Madhya Pradesh | Chhattisgarh | Orissa | Punjab |
|---|---|---|---|---|---|---|---|---|
| 2005-06 | 9.7 | 14.5 | 14.5 | 10.3 | 5.0 | 1.6 | 4.4 | 4.9 |
| 2006-07 | 10.7 | 8.5 | 13.8 | 12.4 | 9.1 | 19.0 | 12.4 | 10.8 |
| 2007-08 | 11.5 | 11.8 | 11.6 | 11.3 | 4.7 | 8.1 | 8.6 | 8.7 |
| 2008-09 | 7.2 | 4.3 | 1.6 | 12.5 | 12.6 | 6.6 | 7.5 | 5.5 |
| 2009-10 | 3.9 | 14.1 | 9.7 | 8.2 | 9.5 | 2.8 | 0.8 | 6.4 |
| 2010-11 | 11.4 | 10.9 | 11.4 | 8.3 | 5.3 | 9.6 | 6.3 | 6.5 |
| 2011-12 | 7.3 | 8.2 | 4.6 | 9.0 | 9.7 | 6.6 | 2.1 | 5.4 |
| 2012-13 | 5.5 | 8.0 | 5.9 | 9.4 | 10.3 | 2.9 | 6.6 | 4.0 |
| 2013-14 | 6.0 | - | 9.8 | 9.4 | 11.3 | 4.5 | 3.2 | 5.2 |
| **5 year CAGR** | **6.8** | **9.0** | **8.2** | **8.9** | **9.2** | **5.3** | **3.8** | **5.5** |

*Source: CSO*

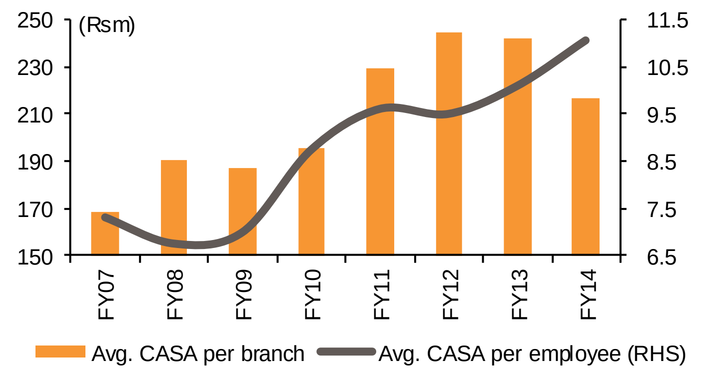
## CASA mobilization likely to improve with sagacious branch additions

Branch expansion is also likely to aid the bank's CASA growth. In the past five years, it has built a strong CASA base with fewer branches than its peers. Branch efficiency in CASA mobilization has been quite noteworthy, with average CASA per branch improving from Rs187m in FY09 to Rs217m in FY14. This is higher than most of its peers, the regional focused banks.

One of its other strengths is its non-unionized work force. This is critical to the bank as it continues on its path of network expansion and business growth. In the past five years, this is likely to have helped it add adequate talent to its staff strength and offer best-in-class compensation based on performance. This has already been reflected in the improvement in CASA mobilisation, as average CASA per employee has risen from Rs7m in FY09 to Rs11m in FY14.

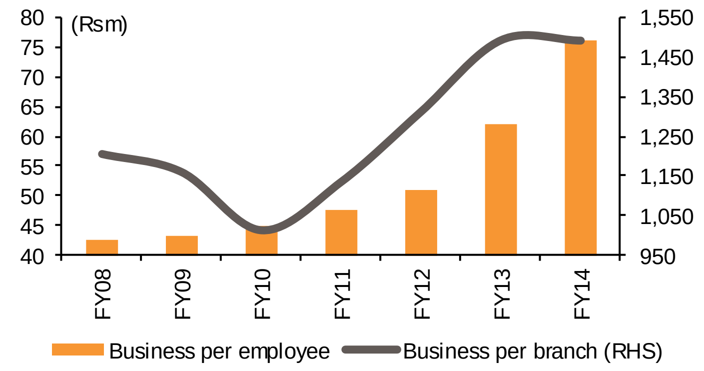
With the RBI's relaxed stance on branch openings in under-banked locations and the bank's recent track record in branch expansion, we expect its network expansion to continue unimpeded. This would provide it with better visibility helping it garner new client relationships in both assets and liabilities. The bank intends to add 30-40 branches every year, depending on the success of its current branches. Hence, the number of its branches is likely to increase to 160 in FY15, 185 in FY16 and 250 by end-CY17.

**Exhibit 18: Gradual rise in average CASA per branch and per employee**



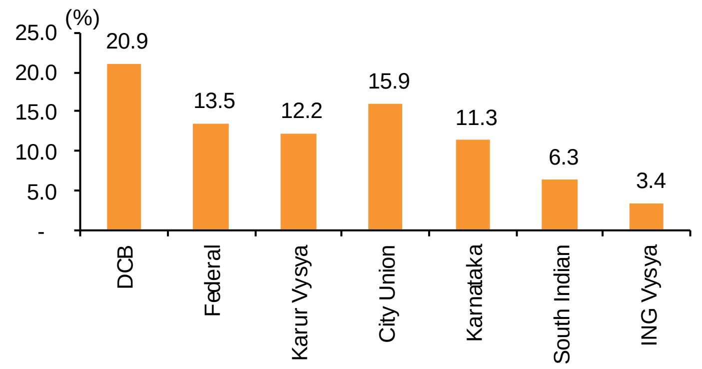

*Source: Company, Emkay Research*

**Exhibit 19: Sharp improvement in business per branch and per employee**



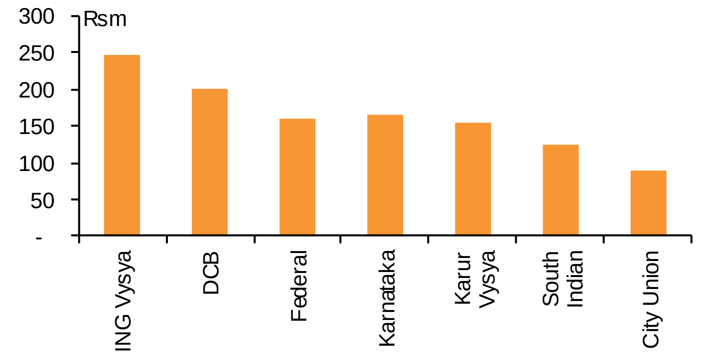

*Source: Company, Emkay Research*

**Exhibit 20: DCB Bank's branch addition (3-year CAGR) was higher than region-focused banks**




*Source: Emkay Research, Company*

**Exhibit 21: DCB Bank's average CASA/ branch is above most region-focused banks**




*Source: Emkay Research, Company*

# Relentless asset quality focus to support profitability

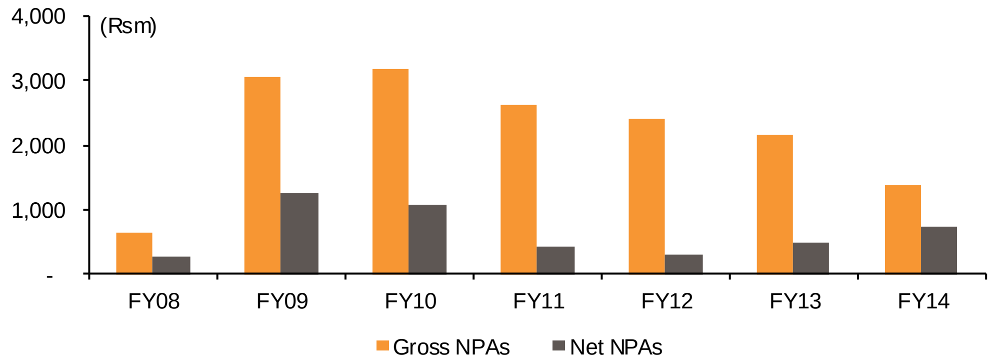
With continuous monitoring, robust credit appraisal and limited exposure to consortium lending and troubled segments, the bank's asset quality is one of the best in the sector. Over time, the bank has also reduced its concentration risks, both in advances and deposits. The management's track record in managing asset quality is commendable, especially in the difficult macroeconomic environment seen over FY10-14. Given this backdrop and a likely pick-up in economic activity, we expect stable credit costs (62bps over FY15-17e) and asset quality to sustain over FY15-17, to drive further profitability.

## Significant improvement in asset quality over FY09-14

With the bank's strategy of recalibration in advances, there has been a gradual but noticeable improvement in asset quality. In FY09 and FY10, the bank registered higher-than-industry slippages, with additions to NPAs being an average 7.8% of loans, owing to the weak economic environment. In this period, the management resorted to containing the damage – an insistent focus on managing asset quality and NPA collections, with ~300 employees concentrating on recoveries. Also, the bank aggressively wrote off non-performing assets. These measures led to gross NPAs (as percentage of advances) declining from 8.8% of advances in FY09 to 5.9% in FY11. Asset quality has since improved. Over FY11-14, slippages (fresh NPA additions) averaged a low 1.2% of advances. Gross NPAs declined from 5.9% in FY11 to 1.7% in FY14, with net NPAs falling from 1% in FY11 to 0.9% in FY14.

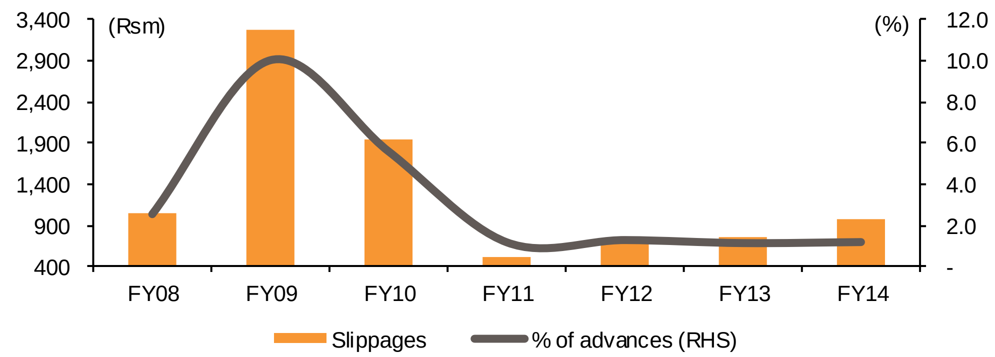
In Dec'14, while gross and net NPAs rose marginally to 1.9% and 1% of loans respectively, overall asset quality remained under control. Additionally, the bank's restructured portfolio, at Rs1.1bn, is just 1.2% of loans, and is among the lowest in the banking sector.

**Exhibit 22: Gross NPAs and net NPAs have decreased**




*Source: Company, Emkay Research*

**Exhibit 23: Slippages have normalized over FY11-14**

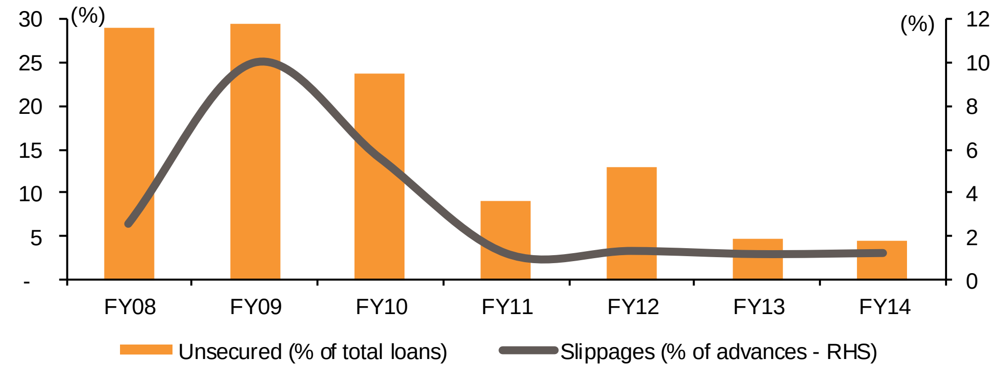



*Source: Company, Emkay Research*

## Management persistent on preserving loan quality

The management has ensured that the bank's credit-risk policy propels growth while simultaneously maintaining assets quality, to ensure long-term sustainable profitability over business cycles. So far, its track record has been exemplary as seen in the sharp asset quality improvement over FY09-14. In a difficult macroeconomic environment, this is only likely to have been possible through continuous monitoring and management, both at the customer and aggregate levels, and a conservative approach within the regulatory prudential exposure norms. In FY14, the management made further improvements, by strengthening its business analytics function and streamlining its MSME account-renewal process. This is likely to augur well for its asset quality in the future.

**Exhibit 24: Falling share of unsecured loans likely to have led to lower slippages**




*Source: Company, Emkay Research*

**Exhibit 25: Regular credit committee meetings to monitor asset quality**

| | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 |
|---|---|---|---|---|---|---|
| Credit Committee meetings | 48 | 38 | 43 | 33 | 30 | 25 |

*Source: Company*

**Exhibit 26: Low exposures to distressed sectors**

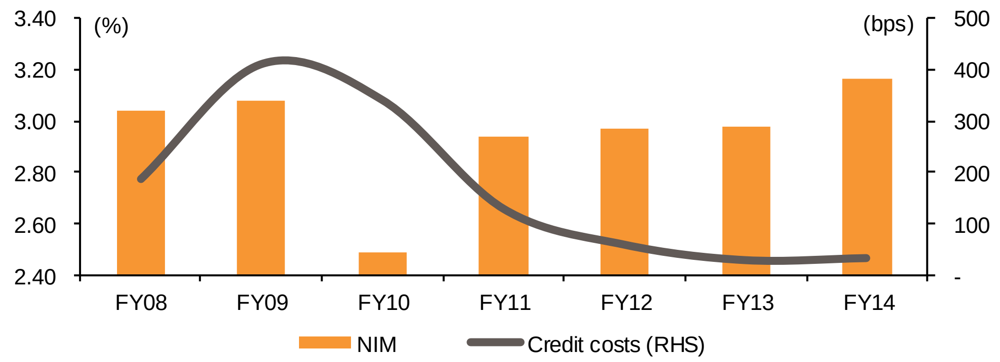
| | Fund based exposures | | | | Non-fund based exposures | | | | Total exposures | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| % | FY09 | FY11 | FY14 | Dec'14 | FY09 | FY11 | FY14 | Dec'14 | FY09 | FY11 | FY14 | Dec'14 |
| Construction | 1.9 | 7.3 | 4.9 | 5.4 | 0.7 | 17.1 | 12.0 | 16.9 | 1.2 | 9.0 | 6.1 | 7.0 |
| Commercial real estate | 3.1 | 12.7 | 5.4 | 6.9 | 0.8 | 2.1 | 0.9 | 1.1 | 1.8 | 11.0 | 4.6 | 6.1 |
| Infra | 0.4 | 0.0 | 2.3 | 1.7 | 4.7 | 8.8 | 6.2 | 7.7 | 2.8 | 1.5 | 2.9 | 2.5 |
| Metals | 0.7 | 1.1 | 2.4 | 1.4 | 3.7 | 14.4 | 2.9 | 3.5 | 2.4 | 3.3 | 2.5 | 1.7 |
| Textiles | 0.6 | 1.8 | 2.3 | 2.3 | 0.0 | 0.0 | 0.3 | 0.4 | 0.2 | 1.5 | 2.0 | 2.0 |
| Gems & jewellery | 0.2 | 0.7 | 0.5 | 0.5 | 2.7 | 2.3 | 0.8 | 0.9 | 1.6 | 1.0 | 0.6 | 0.6 |
| Mining | 0.2 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.6 | 0.0 | 0.0 |

*Source: Company*

Over time, the bank has also reduced its concentration risks, both in advances and deposits. Given the present asset profile and its diversity, the risk of large NPAs has greatly receded. The bank's exposure to the so-called risky or troubled sectors is not high. While its infrastructure exposure (2.5%) compares favourably with most private-sector peers, its exposure to metals is a low 1.7%. Exposure to textiles is a modest 2%, while exposure to gems & jewellery is low at 0.6% and exposure to mining is negligible. Although its exposure to commercial real estate appears high for the bank, most of the exposure comprises of loans against property to SME customers. Here, the primary focus is self-employed customers. The bank does not finance builders or large-ticket loans. Exposure is not large; the average loan size is ~Rs5m, with the maximum capped at Rs30m. Also, the high asset cover offers assurance concerning asset quality.

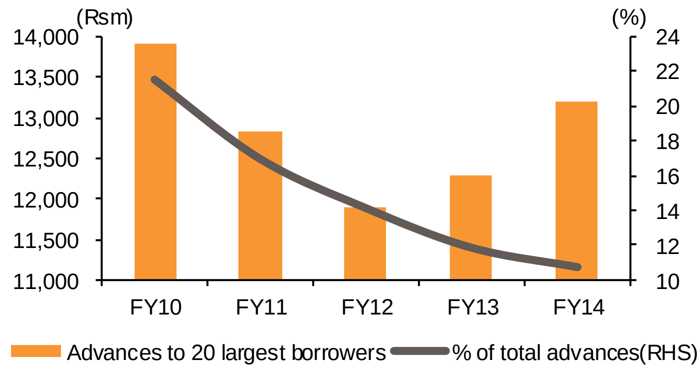
Despite the low share of risky assets and high share of secured loans, where asset yields are usually low, the bank's NIM improved from 3.1% in FY09 to 3.2% in FY14. This might seem at first to be a marginal increase, but when compared to the sharp decrease in NPA provisions over the same period (411bps in FY09 to 33bps in FY14), the risk-adjusted NIM is definitely more attractive.

**Exhibit 27: High risk-adjusted NIM supports profitability**



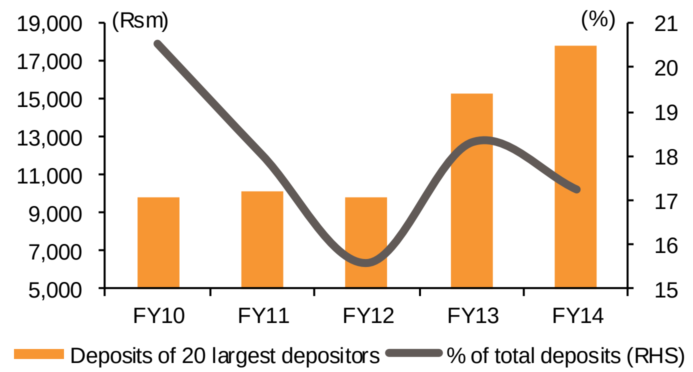

*Source: Company, Emkay Research*

**Exhibit 28: Concentration risk in advances has decreased**




*Source: Company, Emkay Research*

**Exhibit 29: Concentration risk in deposits has decreased**




*Source: Company, Emkay Research*

**Exhibit 30: Conservative growth in "more than 100% risk-weighted assets"**

| Rsm | FY11 | FY12 | FY13 | FY14 | 9MFY15 | CAGR (FY11-14) % |
|---|---|---|---|---|---|---|
| Below 100% risk weight | 30,039 | 36,580 | 49,824 | 70,565 | 74,927 | 32.9 |
| 100% risk weight | 29,051 | 30,854 | 39,045 | 48,662 | 49,829 | 18.8 |
| More than 100% risk weight | 2,535 | 3,114 | 4,061 | 3,252 | 6,707 | 8.7 |
| **Total** | **61,625** | **70,548** | **92,931** | **1,22,479** | **1,31,463** | **25.7** |
| Risk-weighted assets | 50,217 | 57,907 | 74,029 | 85,110 | 98,370 | 19.2 |

*Source: Company, Emkay Research*

## Stable asset quality and credit costs likely to prevail

The improved composition of advances, high share of secured lending and management's insistent focus on maintaining asset quality are likely to support the bank's superior asset quality. We expect fresh slippages to be stable (1.1% of average advances) over FY15-17e, as incremental advances growth is being driven by the housing-loan segment. Additionally, the retail portfolio includes a fair share of loans that have been seasoned and, hence, are faced with low prospects of default. Hence, we expect credit costs to be under control, at 57bps of average loans in FY16 and 53bps in FY17.

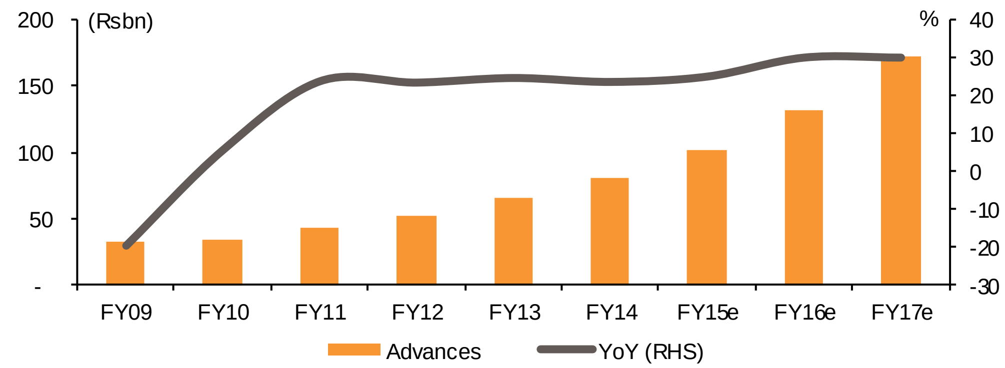
Besides improvement in core earnings, the decline in credit costs was also a large contributor to profitability. Over FY09-14, credit costs declined from 411bps in FY09 to 33bps in FY14, leading to the RoA improving from -1.3% to 1.3% over the same period. Stability in credit costs is likely to support the bank's RoA over FY15-17E.

# Financials

## Robust business CAGR of 28% over FY15-17E

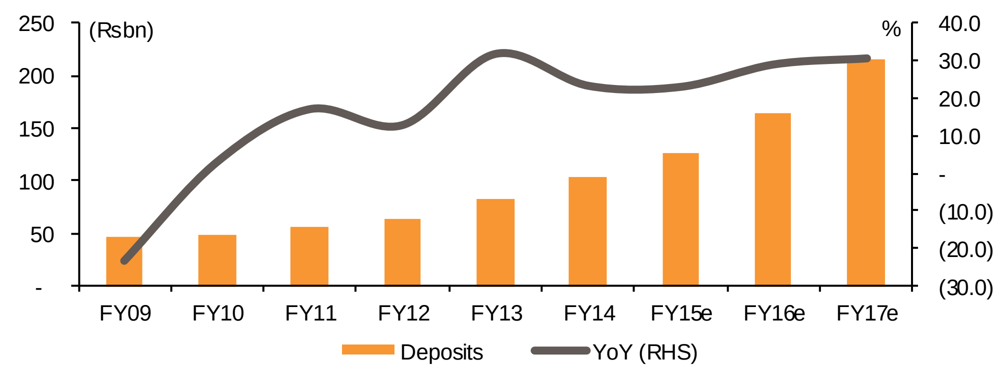
We expect the bank to register business growth of 29.6% in FY16 and 30.5% in FY17. During FY15-17, we expect CAGRs of 28.3% in advances and 27.7% in deposits. Credit growth is likely to be led by secured lending, diversified across the farm, SME, mid-corporate and priority-sector segments. Deposit growth is likely to be led by CASA deposits outpacing overall deposit growth over FY15-17E. The proportion of retail liabilities (CASA + term deposits) is expected to be >75% over FY15-17E.

**Exhibit 31: Robust yet prudent advances growth likely over FY15-17e**




*Source: Company, Emkay Research*

**Exhibit 32: Strong deposit growth likely over FY15-17e**



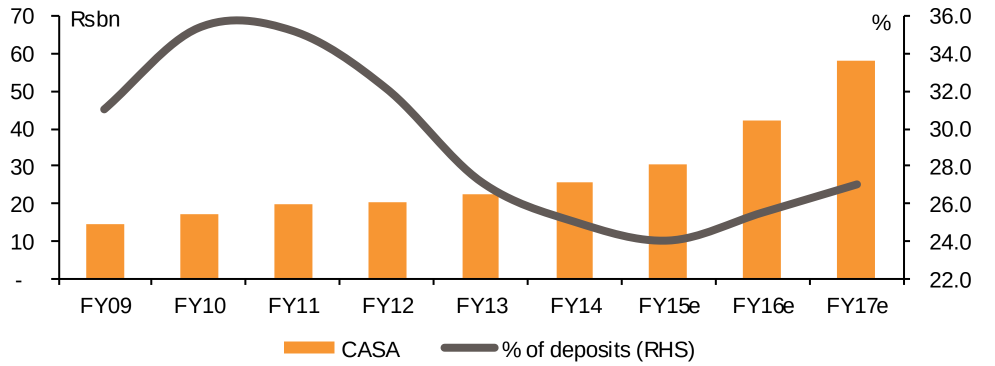

*Source: Company, Emkay Research*

## NIM likely to improve from 3.6% to 3.8% by FY17E

The bank has consistently improved its NIM, from 2.5% in FY09 to 3.2% in FY14. We estimate NIM expansion from 3.2% in FY14 to 3.6% in FY16 and 3.8% in FY17, fuelled by -

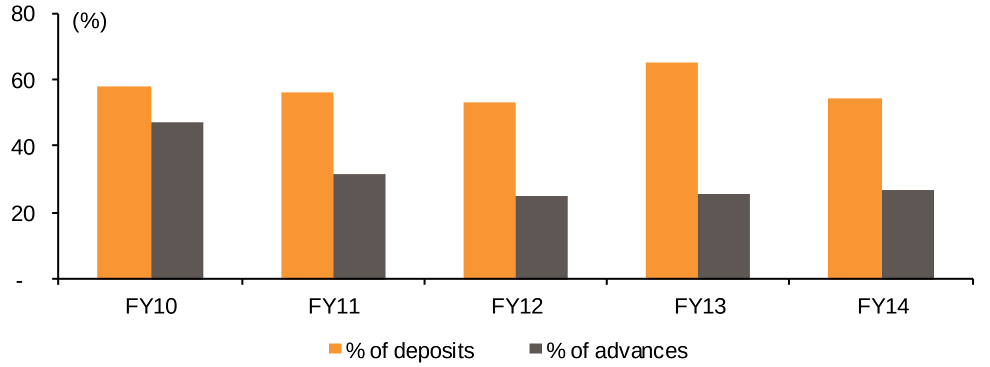
- **Robust CASA growth**: Propelled by its network expansion plans in focused areas, we estimate a 31% CAGR in CASA over FY15-17. Hence, we expect the proportion of CASA in total deposits to improve from 25% in FY14 to 27% in FY17.
- **Improvement in credit rating**: In 2013, CRISIL upgraded the bank's lower tier-2 bonds and CDs programme rating a notch higher to A-/Stable and A1+, respectively. Besides resulting in likely lower cost of borrowings in the wholesale market, it would also provide the management with flexibility to plan balance-sheet growth.
- **Declining share of RIDF investments**: In the past five years, the bank has closed its priority-sector lending (PSL) gap with small shortfalls in sub-limits only. Hence, the share of RIDF investments has fallen sharply, from 9.2% of loans in FY09 to 4.4% in FY14. With better growth in priority-sector assets likely over FY15-17E, we expect the proportion of low-yielding RIDF deposits to slip further, which augurs well for incremental asset yields.
- **Smaller asset-liability mismatch**: The bank's smaller asset-liabilities mismatch is likely to provide solidity to its net interest margins over FY15-17E.

**Exhibit 33: CASA share likely to improve over FY15-17e**




*Source: Company, Emkay Research*

**Exhibit 34: Reducing asset-liability mismatch (<1 year)**




*Source: Company, Emkay Research*

**Exhibit 35: Investments declined in NABARD RIDF (% of advances)**

| | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 |
|---|---|---|---|---|---|---|
| Investments in NABARD RIDF deposits (Rsm) | 3,028 | 3,913 | 3,966 | 3,802 | 3,377 | 3,619 |
| *% of advances* | *9.2* | *11.3* | *9.3* | *7.2* | *5.1* | *4.4* |

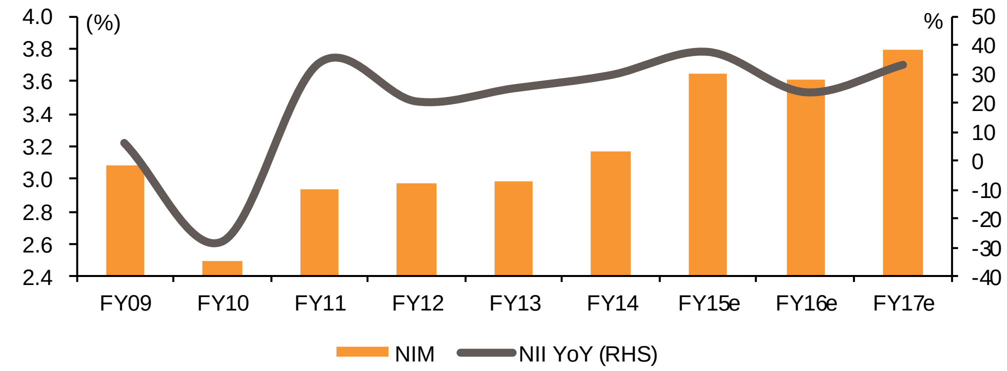
Source: Company, Emkay Research

**Exhibit 36: Credit rating has improved considerably since FY09**

| | CRISIL | | | | ICRA |
|---|---|---|---|---|---|
| | Long term | Short term | Fixed deposits | Brickworks | Fixed deposits |
| 28-Feb-09 | - | P1 | | | |
| 31-Jul-09 | BBB + / Stable | P1 | | BWR A- / Stable | |
| 30-Sep-10 | BBB + / Stable | P1 | | BWR A- / Stable | |
| 30-Sep-11 | BBB + / Stable | A1 | | BWR A- / Stable | |
| 30-Jun-12 | BBB + / Positive | A1 | | BWR A- / Stable | |
| 30-Sep-12 | BBB + / Positive | A1 | | BWR A- / Stable | |
| 31-Dec-12 | BBB + / Positive | A1 | | BWR A- / Stable | |
| 31-Mar-13 | A- / Stable | A1 + | | BWR A- / Stable | |
| 30-Jun-13 | A- / Stable | A1 + | | BWR A- / Stable | |
| 30-Sep-13 | A- / Stable | A1 + | A1 + | BWR A- / Stable | |
| 31-Dec-13 | A- / Stable | A1 + | A1 + | BWR A- / Stable | |
| 31-Mar-14 | A- / Stable | A1 + | A1 + | BWR A- / Stable | |
| 30-Jun-14 | A- / Stable | A1 + | A1 + | BWR A- / Stable | |
| 30-Sep-14 | A- / Stable | A1 + | A1 + | BWR A- / Stable | A1 + |
| 31-Dec-14 | A- / Positive | A1 + | A1 + | BWR A- / Stable | A1 + |

*Source: Company*

**Exhibit 37: NIM likely to improve over FY15-17E**

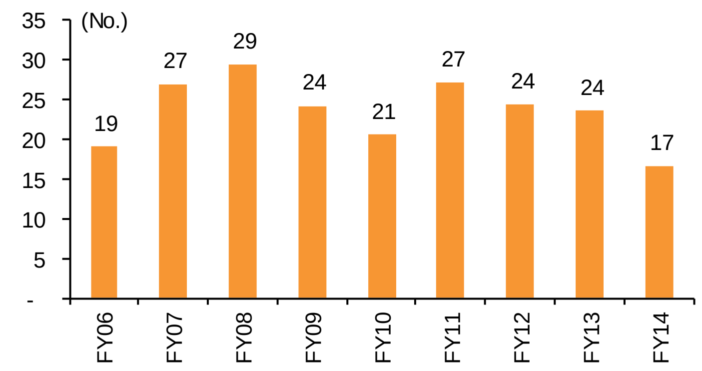



*Source: Company, Emkay Research*

## Productivity gains likely to drive 1.3% RoA by FY17E

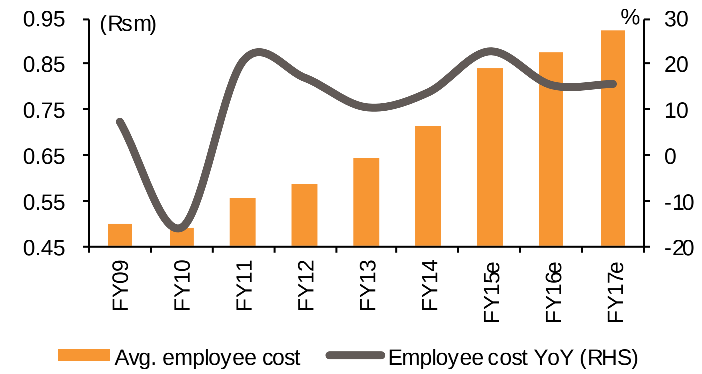
Driven by the likely improvement in business growth, the bank's operating leverage is expected to further improve. While management intends to keep operating expenses in check as far as possible, the bank has centralised most vendors to drive economies of scale. With strong business growth over FY15-17, investment in employees and distribution and technology now in place, we expect the bank's cost-efficiency to gradually trend towards the peer average in the next three years. We expect growth in income and assets to outpace that in operating costs, thereby leading to improved cost-efficiencies. Hence, cost-to-assets for DCB is expected to slip from 2.6% in FY14 to 2.3% in FY17.

**Exhibit 38: Average employee per branch has declined**



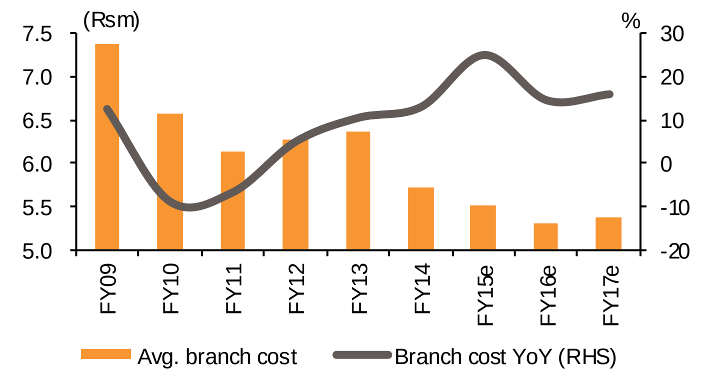

*Source: Company, Emkay Research*

**Exhibit 39: Growth in average employee cost has been modest**



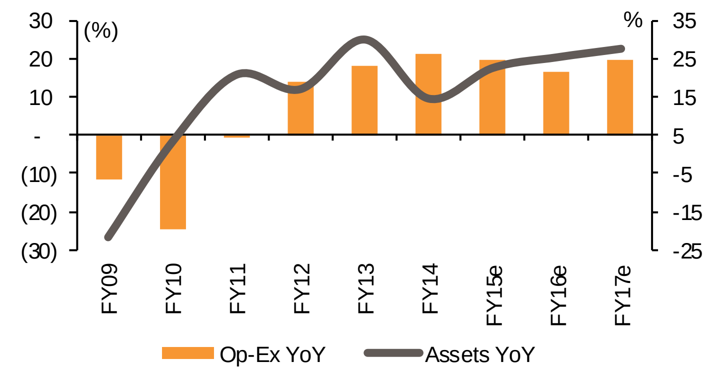

*Source: Company, Emkay Research*

**Exhibit 40: Average branch cost has declined over FY09-14**



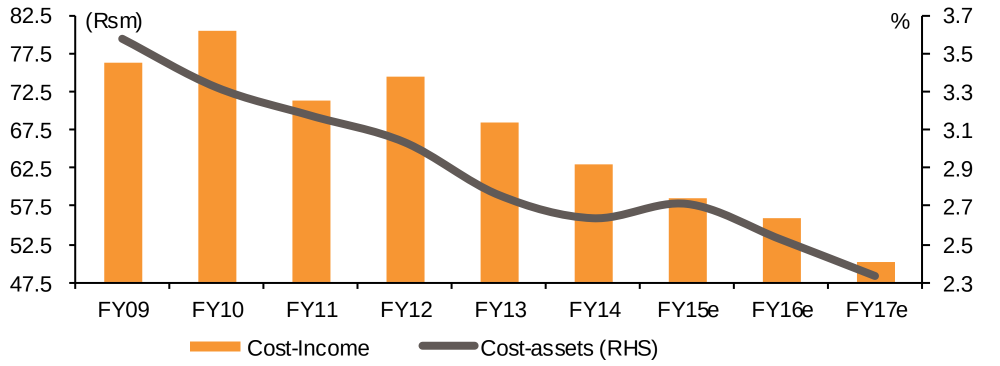

*Source: Company, Emkay Research*

**Exhibit 41: Asset growth likely to outpace operating expenses**




*Source: Company, Emkay Research*

**Exhibit 42: Cost-assets and cost-income likely to further improve**




*Source: Company, Emkay Research*

## Fee-based income has room to progress

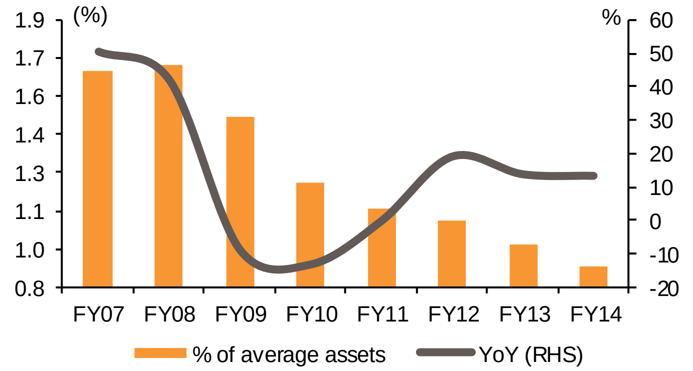
Fee-based income has been modest in the past few years, most likely on account of -

- Focus on balance-sheet stability rather than income diversity in the initial phase of consolidation (FY09-11)
- A declining share of off-balance-sheet assets over FY09-14
- Recent regulatory changes regarding distribution of third-party products such as insurance policies and mutual funds.

Ahead, the bank plans to strengthen its fee income by focusing on its present customer segments. On the MSME and mid-corporate side, fee-based income is likely to be driven by trade and cash-management services, letters of credit and bank guarantees. The bank has steadily increased its cash-management customers from 1,589 in FY13 to 2,207 in FY14. On the retail side, it expects fees from bancassurance (cross-selling traditional insurance products) and distribution of mutual funds to drive growth. By offering its entire bouquet of products at all branches, the bank aims to leverage this base to invigorate its fee-based income stream.

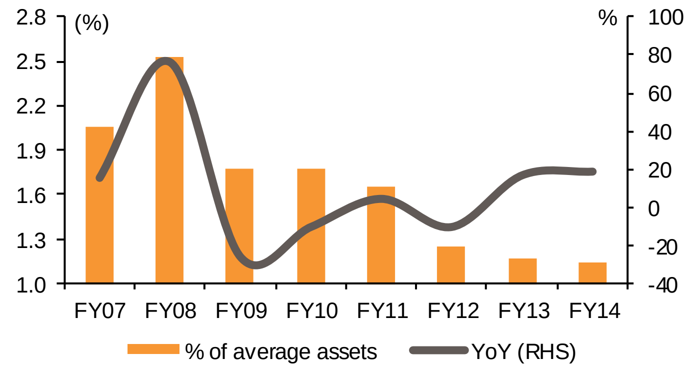
Though fee-based income is likely to be a focus area for management, we expect its growth to come below overall asset growth. We estimate fee-based income to see a 20.9% CAGR over FY14-17, compared to the 12.4% CAGR registered over FY11-14.

**Exhibit 43: Falling share of fee-based income**



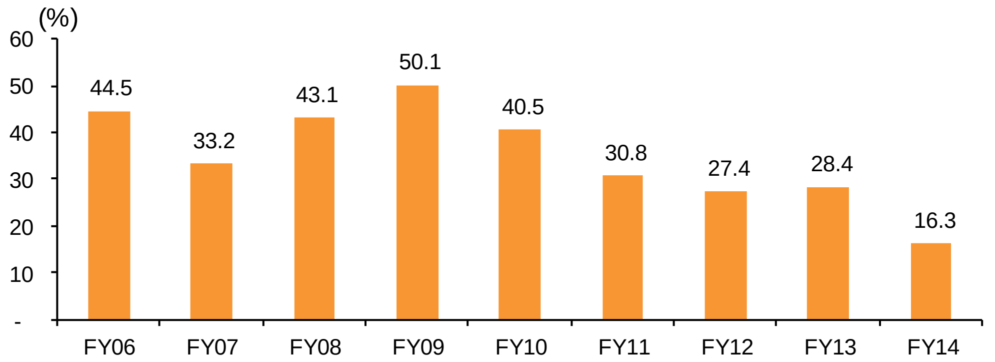

*Source: Company, Emkay Research*

**Exhibit 44: Falling share of non-interest income**




*Source: Company, Emkay Research*

**Exhibit 45: Declining share of off-balance sheet assets**



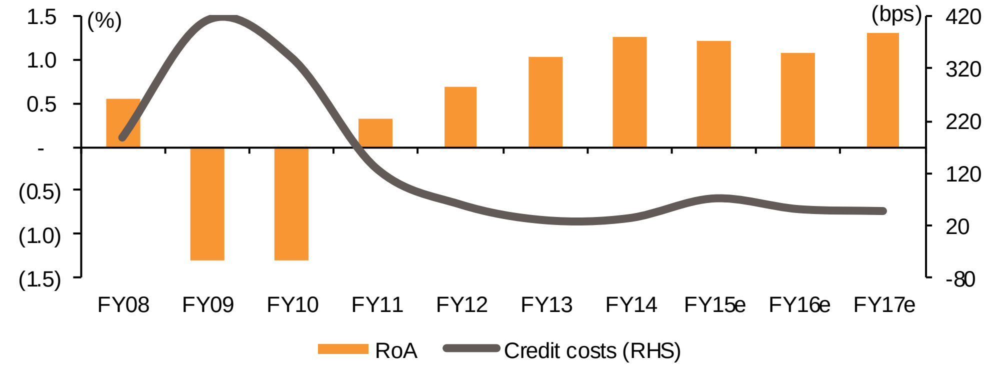

*Source: Company, Emkay Research*

## Stable credit costs likely to drive profitability

The bank's aggressive focus on managing asset quality and NPA collections is likely to result in stable credit costs of 57bps of average loans in FY16 and 53bps in FY17. To factor in any additional delinquencies, we have assumed a 17% CAGR in gross NPAs over FY14-17. We have also assumed average slippages of 1.1% over the same period. Stability in credit costs is likely to support the bank's RoA over FY15-17.

Including technical write-offs, NPA coverage is 77.1%. More importantly, the NPA coverage of unsecured personal loans is close to 100%. We expect NPA coverage at >70% over FY15-17, with net NPAs at 0.7% in FY16 and 0.6% in FY17.

**Exhibit 46: Credit costs vs RoA**




*Source: Company, Emkay Research*

## High capital adequacy to support robust business growth

In Oct'14, the bank raised Rs2,500m, which has further bolstered the bank's capital adequacy . Hence, total capital adequacy stands at 14.4% at present, with tier-1 capital comprising 13.6% of risk-weighted assets. Since tier-2 capital is a low 0.8%, it appears that the bank would not require an immediate dilution of equity. Also, its conservative loan growth in largely secured segments, where risk-weights are low, is not likely to necessitate frequent capital infusion.

However, promoter holding is 16.4%, which goes against the RBI's norm of "no corporate entity having more than a 10% stake in any Indian bank". According to the management, the RBI has allowed the bank some more time to reduce its promoter stake. With the new bank guidelines allowing promoters to hold up to a 15% stake in a bank, one can expect the RBI to consider this holding limit for DCB Bank as well.

**Exhibit 47: Robust RoA likely to persist over FY16-17e**

| (% of total assets) | FY07 | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 | FY15e | FY16e | FY17e |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Net Interest Income** | **2.7** | **2.9** | **2.9** | **2.3** | **2.8** | **2.8** | **2.9** | **3.0** | **3.5** | **3.5** | **3.7** |
| Other Income | 2.1 | 2.5 | 1.8 | 1.8 | 1.7 | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 | 1.0 |
| Commission , Exchange & Brokerage | 1.3 | 1.3 | 1.1 | 1.1 | 1.0 | 1.0 | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 |
| Profit on sale of Investment (Net) | 0.1 | 0.3 | 0.0 | 0.3 | 0.4 | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 | 0.1 |
| Others | 0.6 | 0.9 | 0.6 | 0.4 | 0.3 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Operating Expenses** | **3.8** | **3.7** | **3.6** | **3.3** | **3.2** | **3.0** | **2.8** | **2.6** | **2.7** | **2.5** | **2.3** |
| Salaries & Benefits | 1.5 | 1.5 | 1.5 | 1.5 | 1.6 | 1.5 | 1.4 | 1.3 | 1.3 | 1.3 | 1.1 |
| Other Operating Expenses | 2.3 | 2.2 | 2.0 | 1.9 | 1.6 | 1.5 | 1.4 | 1.3 | 1.4 | 1.3 | 1.2 |
| **Pre-provisioning profits** | **0.9** | **1.7** | **1.1** | **0.8** | **1.3** | **1.0** | **1.3** | **1.6** | **1.9** | **2.0** | **2.3** |
| Provisions | 0.9 | 1.1 | 2.4 | 2.0 | 0.8 | 0.4 | 0.2 | 0.3 | 0.5 | 0.4 | 0.4 |
| NPAs | 0.8 | 1.0 | 2.2 | 1.9 | 0.7 | 0.4 | 0.2 | 0.2 | 0.4 | 0.3 | 0.3 |
| Investment depreciation | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | (0.0) | (0.0) | - | - | - |
| Others | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | (0.0) | 0.1 | 0.1 | 0.0 | 0.1 | 0.1 |
| Tax | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.2 | 0.5 | 0.7 |
| **Net profit (RoA)** | **0.2** | **0.6** | **(1.3)** | **(1.3)** | **0.3** | **0.7** | **1.0** | **1.3** | **1.2** | **1.1** | **1.3** |

*Source: Company, Emkay Research*

## Valuations likely to sustain on improved fundamentals

We expect robust profitability over FY15-17E, led by the bank's prudent business growth strategy, focused network expansion and superior asset quality. We initiate coverage on DCB Bank with a Buy rating. We expect the bank to maintain a 1.2% RoA over FY15-17e, despite paying the full income-tax rate unlike in the past. As a result, we believe that the stock will continue to enjoy premium valuations. Our target price of Rs140 is based on the two-stage dividend-discount model (CoE: 15.9%; beta: 1.2; Rf: 7.5%). At our target price, it would trade at PABV of 2.3x FY16e and 2xFY17e.

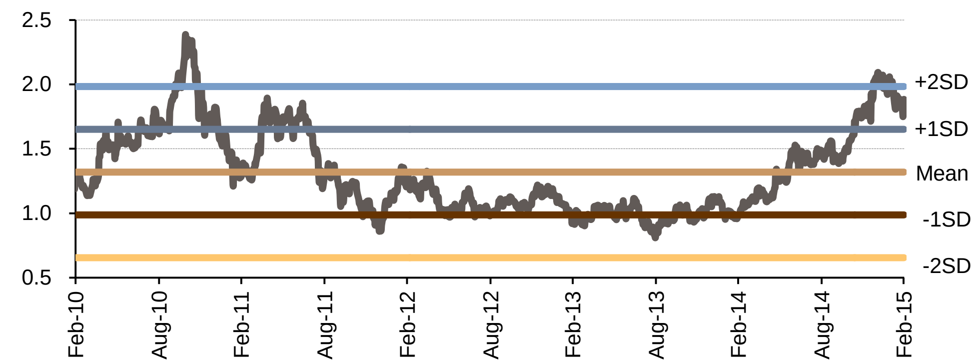
Our Mar'17 target price of Rs140 implies a 25% upside. Key reasons for our Buy rating are:

**Improved quality of the balance-sheet to persist:** At present, DCB Bank liability franchise is healthy, with retail deposits comprising 81.5% of total deposits and savings deposits comprising ~63% of CASA. Advances are largely secured, with superior asset quality - net NPA of 1% and NPA coverage (including technical write-offs) of 77.1%, (one of the lowest among peers). We expect management to persist with this strategy in business growth.

**Robust PAT CAGR despite paying full income-tax:** We forecast a strong 24.7% CAGR in profit over FY14-17E, with average RoA of 1.2% over the same period, one of the best among small-cap banking peers. We expect the RoA to improve from 1.1% in FY16E to 1.3% in FY17E. Also, we expect the bank's RoE to improve from 11.5% to 15.3% over the same period. A noteworthy point is that this improvement in profitability would be despite the bank paying the full income-tax rate, unlike in the past.

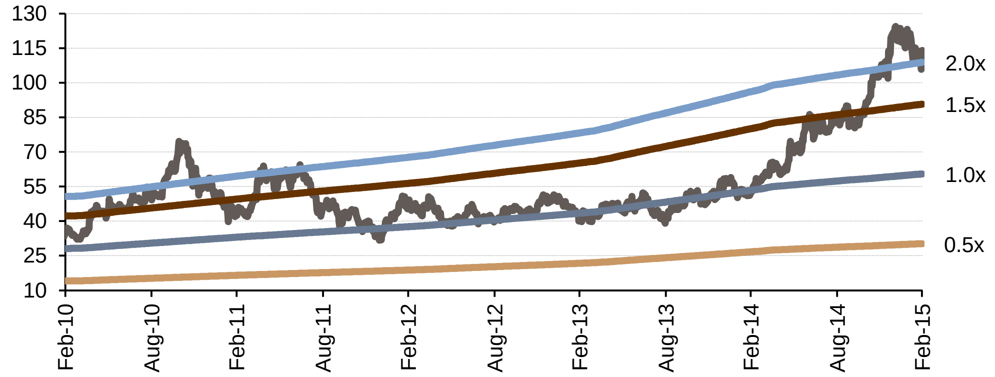
**Well-capitalized for growth opportunities:** In Oct'14, the bank raised Rs2,500m, which has further bolstered the bank's capital adequacy . Hence, total capital adequacy stands at 14.4% at present, with tier-1 capital comprising 13.6% of risk-weighted assets. Since tier-2 capital is a low 0.8%, the bank would not require frequent capital infusion. The high capital position of the bank enables it to take advantage of any credit opportunities, should there be a strong economic recovery. Also, its conservative loan growth in largely secured segments, where risk-weights are low, is not likely to necessitate frequent capital infusion.

**Exhibit 48: Past one-year forward PBV (x)**



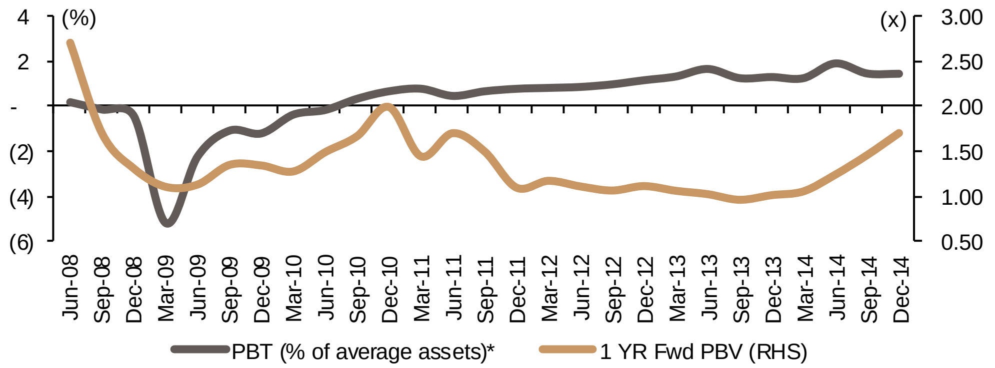

*Source: Bloomberg, Emkay Research*

**Exhibit 49: Price-to-book band**




*Source: Bloomberg, Emkay Research*

**Exhibit 50: RoA vs PBV: Valuations seem to capture better fundamentals ahead**




*Source: Bloomberg, Emkay Research*

**Exhibit 51: Valuation matrix: Peer banks**

| | Target PBV | | Price target (Rs) | PAT CAGR | RoE (%) | | RoA (%) | | PPP* (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | FY16e | FY17e | | FY14-17e | FY16e | FY17e | FY16e | FY17e | FY16e | FY17e |
| **DCB Bank** | **2.3** | **2.0** | **140** | **24.7** | **11.5** | **15.3** | **1.1** | **1.3** | **2.0** | **2.3** |
| South Indian Bank | 1.0 | 0.9 | 29 | 6.3 | 13.0 | 14.8 | 0.8 | 0.9 | 1.6 | 1.7 |
| Federal Bank | 1.7 | 1.5 | 168 | 16.8 | 13.6 | 14.8 | 1.2 | 1.2 | 2.1 | 2.1 |
| Yes Bank | 2.6 | 2.2 | 851 | 22.9 | 19.3 | 20.2 | 1.7 | 1.7 | 2.7 | 2.8 |
| IndusInd Bank | 3.8 | 3.2 | 866 | 25.2 | 20.1 | 21.1 | 1.9 | 1.9 | 3.3 | 3.3 |

*Source: Emkay Research*

**Exhibit 52: Sensitivity of target price**

| Scenario | Assumptions | Advances CAGR (%) | PAT CAGR (%) | BV (Rs) | | RoA (%) | Target PBV (x) | | Price target (Rs) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | FY14-17e | FY14-17e | FY16e | FY17e | FY17e | FY16e | FY17e | FY16e | FY17e |
| Bull case | Healthy operating environment, monetary easing, robust growth in business, cost-income declining to 47.5% by FY17e, slippages at 1% of loans | 33.6 | 28.8 | 69 | 81 | 1.3 | 2.2 | 2.1 | 153 | 170 |
| Base case | Gradually improving operating environment, benign monetary policy, robust growth in business, cost-income declining to 50% by FY17e, slippages at 1.1% of loans, no capital infusion | 28.3 | 24.7 | 61 | 71 | 1.3 | 2.1 | 2.0 | 125 | 140 |
| Bear case | Benign operating environment, possible monetary tightening, modest growth in business, cost-income declining to 57% by FY17e, slippages at 1.3% of loans, no capital infusion | 24.0 | 11.5 | 57 | 65 | 1.0 | 1.5 | 1.4 | 85 | 92 |

*Source: Emkay Research*

## Risks to our target price

- Change in management - Any change in key personnel could alter the bank's growth strategy and impact our earnings estimates.
- Irrational competition from large banks could hurt the market share of a smaller bank such as DCB, affecting business growth.
- Aggressive monetary tightening could lead to a tight liquidity environment for banks, impacting their ability to effectively manage spreads.
- Sharp slowdown in economic growth. We have factored in a small rise in the bank's NPAs over FY15-17. Slower-than-estimated economic growth could lead to higher-than-estimated deterioration in asset quality, cutting our earnings estimates and target price.

# Company Background & Management

In Dec'14, DCB Bank had 145 branches and 292 ATMs in 94 locations, covering 17 states. It is concentrated in Goa, Gujarat and Maharashtra and is gradually expanding its reach to Madhya Pradesh and Chhattisgarh in central India, Andhra Pradesh and Telangana in south India and Orissa in east India. It was listed on the Indian stock exchanges in 2006.

## Background

DCB Bank was founded in 1930 as a co-operative bank by its promoter, the Aga Khan Fund for Economic Development (AKFED), which holds more than an 18% stake. AKFED operates as a network of affiliates comprising of 90 project companies. DCB Bank was converted into a scheduled commercial bank (SCB) on 31 May'95.

## Management

- **Murali M Natrajan** joined as managing director and CEO in Apr'09. Prior to this, he was the global head for SME banking at Standard Chartered Bank. He has over 25 years of experience in India, Singapore, Hong Kong, Korea and Indonesia. Natrajan is a fellow member of The Institute of Chartered Accountants of India. He started his career with American Express TRS in India, where he worked for five years before joining Citibank in 1989. In Citibank, he spent 14 years and fulfilled various functions, including director of the cards business in Indonesia and Hong Kong. He joined Standard Chartered Bank in Oct'02 as general manager for the mortgage & auto business for Southeast Asia. In Nov '04, he took over as head of consumer banking for India and Nepal. In Jun'08, he moved to Singapore as global head for SME banking.
- **Bharat Sampat** has been the CFO since Sep'08. He is a chartered accountant and cost accountant, along with being a post-graduate in law. Sampat has over 28 years of experience in senior positions with reputed organisations such as ABN Amro Bank, ANZ Grindlays Bank, Standard Chartered Bank, Hoechst India and Larsen & Toubro. He has worked in diverse industries such as manufacturing, banking, finance and shared services, overseeing financial accounting, financial control & reporting and management accounting, both in India and abroad.

**Exhibit 53: Experienced management team**

| Name | Designation | Experience |
|---|---|---|
| Abhijit Bose | Head – Retail Assets & Strategic Alliances | Standard Chartered Bank, Citibank, Eldeco Housing Industries & GIC Housing-20 yrs experience |
| Aditya Prasad | Head - Credit | Saudi Investment Bank, Axis Bank, State Bank of India – 28 yrs experience |
| Ajay Mathur | Head – Collections & Commercial Vehicles | CGSL and Citibank – 21 yrs experience |
| Damodar Agarwal | Head – Alternate Channels & Retail Securitization | ICICI Bank Ltd., BGF Ltd.– 18 yrs experience |
| J. K Vishwanath | Chief Credit Officer | Fullerton India, Citigroup and Eicher Group – 19 yrs experience |
| Krishna Ramasankaran | Head Credit – Retail Assets | Fullerton India Credit Company Ltd., Citicorp Finance (I) Ltd., Ashok Leyland Ltd.-18 yrs experience |
| Manoj Joshi | Head – SME & MSME Banking | ICICI Bank, Epcos Ferrites and Uniworth Group – 17 yrs experience |
| Narendranath Mishra | Head - AIB | ICICI Bank and Rallis India – 13 yrs experience |
| Pankaj Sood | Head – Liability Products, TPD & TCB | IDBI Bank – 17 yrs experience. |
| Praveen Kutty | Head – Retail & SME Banking | Citibank – 21 yrs experience |
| R. Venkattesh | Head - HR, IT & Operations | Standard Chartered Bank, ANZ Grindlays Bank, Hindustan Petroleum – 22 yrs experience |
| Rajesh Verma | Head - Treasury & Corporate Banking | State Bank of India – 33 yrs experience |
| Atal Agarwal | Head- Corporate Banking, FIG & Investment Banking | RBS, Citibank, DSP Merrill Lynch, Barclays Capital – 25 yrs experience |

*Source: Company*

## Key Financials (Standalone)

### Income Statement

| Y/E Mar (Rs mn) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| **Net interest income** | **2,844** | **3,684** | **5,066** | **6,260** | **8,329** |
| **Other income** | **1,170** | **1,387** | **1,589** | **1,819** | **2,195** |
| Fee income | 893 | 1,011 | 1,162 | 1,424 | 1,780 |
| **Net income** | **4,014** | **5,071** | **6,655** | **8,078** | **10,524** |
| Operating expenses | 2,753 | 3,191 | 3,901 | 4,508 | 5,272 |
| **Pre provision profit** | **1,261** | **1,880** | **2,755** | **3,571** | **5,251** |
| **PPP excl treasury** | **1,122** | **1,655** | **2,505** | **3,392** | **5,101** |
| Provisions | 240 | 366 | 715 | 685 | 837 |
| **Profit before tax** | **1,021** | **1,514** | **2,040** | **2,886** | **4,414** |
| Tax | 0 | 0 | 306 | 967 | 1,479 |
| Tax rate | 0 | 0 | 15 | 34 | 34 |
| **Profit after tax** | **1,021** | **1,514** | **1,734** | **1,919** | **2,935** |

### Balance Sheet

| Y/E Year End (Rs mn) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Equity | 2,531 | 2,533 | 2,808 | 2,822 | 2,836 |
| Reserves | 7,499 | 9,007 | 12,964 | 14,882 | 17,818 |
| **Net worth** | **10,031** | **11,540** | **15,771** | **17,704** | **20,654** |
| Deposits | 83,638 | 1,03,252 | 1,27,190 | 1,64,321 | 2,14,952 |
| Borrowings | 15,256 | 8,602 | 9,032 | 9,483 | 9,957 |
| **Total liabilities** | **1,12,788** | **1,29,231** | **1,58,416** | **1,98,572** | **2,53,334** |
| Cash and bank | 3,788 | 5,051 | 9,302 | 9,398 | 11,436 |
| Investments | 33,587 | 36,342 | 42,609 | 50,939 | 62,336 |
| Loans | 65,861 | 81,402 | 1,01,752 | 1,32,278 | 1,71,961 |
| Others | 2,114 | 2,205 | 2,614 | 3,276 | 4,180 |
| **Total assets** | **1,12,788** | **1,29,231** | **1,58,416** | **1,98,572** | **2,53,334** |

### Key Ratios (%)

| Y/E Year End | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| NIM | 3.0 | 3.2 | 3.6 | 3.6 | 3.8 |
| Non-II/avg assets | 1.2 | 1.1 | 1.1 | 1.0 | 1.0 |
| Fee income/avg assets | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 |
| Opex/avg assets | 2.8 | 2.6 | 2.7 | 2.5 | 2.3 |
| Provisions/avg assets | 0.2 | 0.3 | 0.5 | 0.4 | 0.4 |
| PBT/avg assets | 1.0 | 1.3 | 1.4 | 1.6 | 2.0 |
| Tax/avg assets | 0.0 | 0.0 | 0.2 | 0.5 | 0.7 |
| RoA | 1.0 | 1.3 | 1.2 | 1.1 | 1.3 |
| RoAE | 10.9 | 14.0 | 12.7 | 11.5 | 15.3 |
| GNPA (%) | 3.2 | 1.7 | 1.7 | 1.5 | 1.3 |
| NNPA (%) | 0.8 | 0.9 | 0.8 | 0.7 | 0.6 |

| Per Share Data (Rs) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| EPS | 4.0 | 6.0 | 6.2 | 6.8 | 10.4 |
| BVPS | 39.6 | 45.6 | 56.2 | 62.7 | 72.8 |
| ABVPS | 37.7 | 42.6 | 53.1 | 59.5 | 69.2 |
| DPS | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| Valuations (x) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| PER | 27.9 | 18.8 | 18.2 | 16.5 | 10.9 |
| P/BV | 3.0 | 2.6 | 2.1 | 1.9 | 1.6 |
| P/ABV | 3.0 | 2.6 | 2.1 | 1.9 | 1.6 |
| P/PPOP | 22.6 | 15.2 | 11.5 | 8.9 | 6.1 |
| Dividend Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| Growth (%) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| NII | 24.9 | 29.5 | 37.5 | 23.6 | 33.1 |
| PPOP | 50.5 | 49.0 | 46.5 | 29.6 | 47.1 |
| PAT | 85.3 | 48.3 | 14.6 | 10.7 | 53.0 |
| Loans | 24.6 | 23.6 | 25.0 | 30.0 | 30.0 |

| Quarterly (Rs mn) | Q3FY14 | Q4FY14 | Q1FY15 | Q2FY15 | Q3FY15 |
|---|---|---|---|---|---|
| NII | 940 | 1,000 | 1,390 | 1,177 | 1,219 |
| NIM(%) | 3.6 | 3.4 | 3.8 | 4.0 | 3.8 |
| PPOP | 464 | 502 | 812 | 598 | 684 |
| PAT | 364 | 391 | 446 | 411 | 425 |
| EPS (Rs) | 5.81 | 6.24 | 7.13 | 6.55 | 6.04 |

| Shareholding Pattern (%) | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 |
|---|---|---|---|---|---|
| Promoters | 33.9 | 29.5 | 29.2 | 28.9 | 28.2 |
| FIIs | 43.2 | 48.8 | 48.5 | 47.6 | 48.6 |
| DIIs | 9.8 | 10.0 | 11.1 | 10.8 | 11.3 |
| Private Corp | 1.6 | 1.4 | 1.6 | 1.5 | 1.2 |
| Public | 13.2 | 11.6 | 11.3 | 12.7 | 11.8 |

## Emkay Rating Distribution

| | |
|---|---|
| BUY | Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months. |
| ACCUMULATE | Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months. |
| HOLD | Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months. |
| REDUCE | Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months. |
| SELL | The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months. |

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