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Initiating Coverage
DCB Bank Ltd.

14-December-2020

RETAIL RESEARCH

DCB Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Private Bank	116.8	Buy at LTP and add on dips to Rs.105-107 band	Rs. 132.5	Rs. 144	2 quarters

HDFC Scrip Code	DCBLTD
BSE Code	532772
NSE Code	DCBBANK
Bloomberg	DCBB IN
CMP Dec 11, 2020	116.8
Equity Capital (Rscr)	311.0
Face Value (Rs)	10.0
Eq- Share O/S (cr)	31.1
Market Cap (Rscrs)	3626.2
Book Value (Rs)	110.2
Avg. 52Wk Volumes	2190435
52 Week High	204.5
52 Week Low	58.0

Share holding Pattern % (Sept, 2020)	
Promoters	14.9
Institutions	52.1
Non Institutions	33.0
Total	100.0

Fundamental Research Analyst
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Our Take:

DCB Bank has managed to maintain healthy capitalisation, sustainable and calibrated growth in advances with continued focus on the SME segment, competitive NIMs, comfortable asset quality with stable management team. The company has strong capital adequacy, a comfortable liquidity position, a resilient operating model and increasing retail mix. The bank has created niche in mortgage financing (~40% of total advances) with emphasis on small ticket loans (ticket size ~3-3.5mn) to self-employed in Tier II-VI cities. The portfolio is well diversified with greater reliance on secured lending (~96% of the total loans are secured). Retail focus will help the Bank to deliver double digit growth in loan book from next fiscal.

Over the years, the bank has gained expertise in the high yielding self-employed small ticket loan segment and has managed to deliver loan book growth with limited incremental slippages. The management has reiterated focus on increasing the share of retail deposits, especially retail term deposits, and improving the granularity of deposits. The Bank's intention to focus on Business Loans (LAP), Home Loans, Gold Loans, KCC (Kissan Credit Card), Tractor Loans and short term Corporate Loans is in the right direction to improve loan book. Higher credit growth, marginal compression in margins, sharp improvement in operating efficiency and contained credit cost will help in improvement of return ratios.

Valuations & Recommendation:

DCB Bank's ability to improve its cost of funds vis-à-vis its peers, further reduce the asset-liability gaps in the near-term buckets and maintain the asset quality will remain key driver. The bank is well capitalised (CAR 18.28% and Tier I 14.2%) and has the ability to raise funds well ahead of requirement. It has strong support from its promoter AKFED which has infused capital in the past either directly or through associated entities. Focus on Tier-2 to Tier-6 locations would support growth as competition is lesser in these locations and increase granularity of loan book. Amid the current economic environment and subdued lending in a stressed scenario of higher slippages, the bank's capital position and solvency metrics is likely to remain comfortable.

DCB Bank's key strength lies in robust assets side of the business; the bank has been able to gain credit market share with stable credit quality. Though we remain optimistic on its retail focus and the segment is caters to; we are cautious on growth stance given moderate

CASA ratio and credit pressure in mortgage, SME and corporate loan book. Though DCB Bank has concerns like weak fee, high cost structure & sub-optimal return metrics, a pro-active management & cheap valuations offer attractive risk reward profile. We think the base case fair value of the stock is Rs.132.5 (1.15xFY22E ABV) and the bull case fair value is Rs.144 (1.25xFY22E ABV) over the next two quarters. Investors can buy the stock at LTP and add on dips to Rs.105-107 band (0.92xFY22E ABV). At the LTP of Rs.116.8 it quotes at 1.01xFY22E ABV.

Financial Summary (Consolidated)

Particulars (Rs cr)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY18	FY19	FY20	FY21E	FY22E
NII	333.9	313.4	*6.6*	306.7	*8.9*	995	1,149	1,265	1,275	1,422
PPoP	224.8	184.5	*21.9*	191.1	*17.6*	525	647	753	803	882
PAT	82.3	91.34	*-9.9*	79.4	*3.7*	245	325	338	311	385
EPS (Rs)	2.7	2.9	*-10.1*	2.6	*3.7*	8.0	10.5	10.9	10.0	12.4
RoAE (%)						9.8	11.0	10.3	8.7	9.8
RoAA (%)						0.9	1.0	0.9	0.8	0.9
Adj. BVPS (Rs)						78.2	87.8	93.1	94.2	115.2
P/E (x)						14.7	11.1	10.7	11.6	9.4
P/ABV (x)						1.5	1.3	1.3	1.2	1.0

(Source: Company, HDFC sec)

Q2FY21 Result Review

DCB Bank reported better than expected operating performance recording PPoP growth of 17.6% QoQ/21.9% YoY, aided by NIM expansion of 32bps (QoQ). The bank reported decline in PAT 10% YoY on account of increased provisions. Strong cost control measures pulled opex cost lower – down 12.4%YoY improving cost-income ratio to 47.3% from 50.3% in the previous quarter. Net interest margin (NIM) (reported) was marginally up (7bps) YoY at 3.74%, mainly because of sharp fall in cost of funds (52bps YoY); with yield on advances declining 25bps YoY reflecting a decline in MCLR rates. The management has reiterated focus on increasing the share of retail deposits, especially retail term deposits, and improving the granularity of deposits. The bank continued to maintain surplus liquidity (average LCR for 2QFY21 was 141.9%), which could be drag on NIM.

Provision for Q2FY21 increased 35.1% QoQ to Rs 131cr, which included additional COVID-19 related provision of Rs 48cr. Headline GNPA dipped 7.7% QoQ to Rs 574cr. The Gross NPA as on September 30, 2020 was at 2.27% and Net NPA was at 0.83%. Provision coverage ratio stood at ~64% as of Q2FY21. The bank saw an improvement in collection efficiency metrics across segments— LAP (87.5%), home loans (91.3%), CV loans (77.1%) in Sep month. The bank expects to restructure 3-5% of its portfolio. Capital Adequacy continues to be strong at 18.28% as on September 30, 2020.

Loan book growth was flat and is likely to remain subdued in FY21. Management sounded caution on further loan book growth. Significant reduction was recorded in its corporate banking, commercial vehicle loan and Agri & inclusive business (down 16.4%, 14%, 8% respectively YoY). The Bank intends to focus on Business Loans (LAP), Home Loans, Gold Loans, KCC (Kissan Credit Card), Tractor Loans and short term Corporate Loans. Deposits slipped sequentially for second consecutive quarter (down 2% YoY). Retail deposits continue to see strong traction due to the bank's efforts to mobilize retail term deposits, while CASA deposits dropped 5.4% YoY in Q2FY21. The higher credit costs and weaker operating performance (attributed to slower business growth) would keep the bank's earnings muted in FY21.

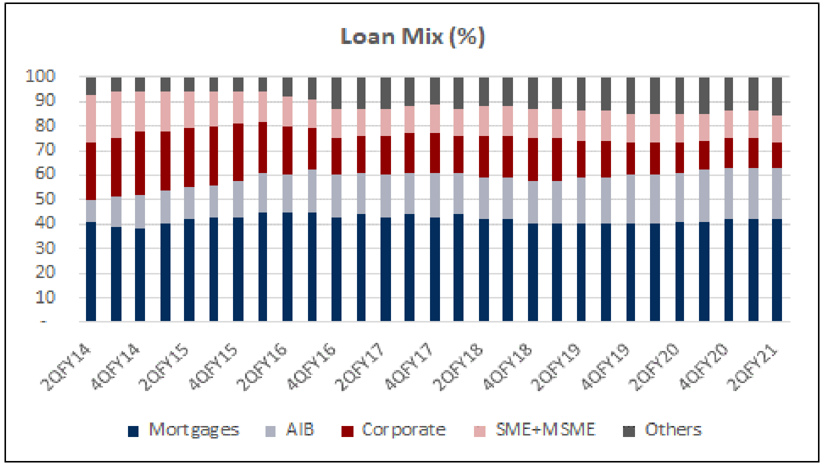
Triggers

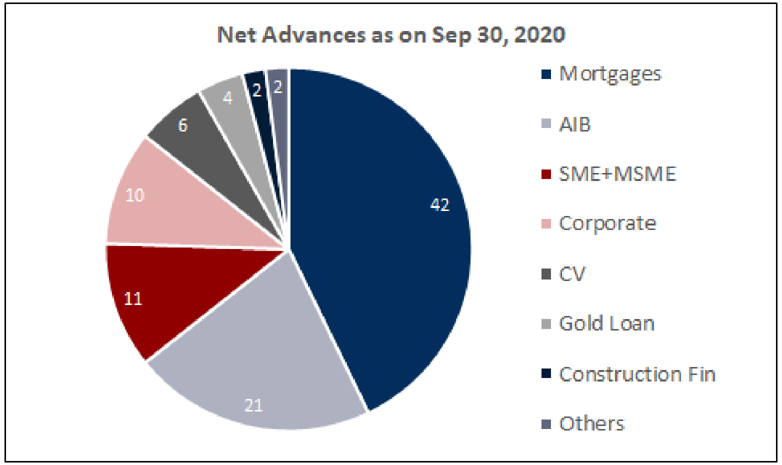
Diversified Loan Book, largely SME driven:

The bank's advances grew at a robust 17% CAGR in three year period ended FY20. As of Sep 30, 2020, the bank's advances book was fairly diversified and granular. In terms of credit composition, mortgage loans accounts for 42% (largely Loan Against Property). Self-employed constitute major part of the mortgage portfolio with comfortable LTV providing sufficient cover amid rising risk of depreciation in collateral values. Other loan book category - Agriculture & Inclusive Banking (AIB) lending was at 21%, Corporate lending was at 10%. While the direct lending to MSME segment is about 11%, a significant portion of the mortgage book is advanced to MSMEs against collateral of their property. The MSME sector plays a pivotal role in the economic and social development of the country. There is clear regulatory support for the MSME segment, which will have a positive second order impact for bank lending to the MSME segment. Loan book growth was flat sequentially with mortgage book and AIB segment witnessing some traction; rest all categories witnessed de-growth YoY in Q2FY21. The bank's presence in the corporate segment is also characterised by a well-diversified borrower profile with a median ticket size of Rs. 40cr among the top 100 borrowers. As a result, the bank's advances are well-diversified with a relatively low exposure to sensitive sectors such as infrastructure, construction and commercial real estate.

DCB Bank Ltd.

The Bank has chosen to have limited presence in the salaried segment, growth is likely to skew more towards smaller ticket (non-salaried) loans contributing higher NIMs compared to its midcap peers and has garnered expertise in this segment. In terms of customer profile, DCB bank lends to self-employed and small businesses, such as trader, retailer, commission agent, consultant, doctor, hotel owner, coaching class owner and grocery stores. However, given the inherent risks linked with this segment, the bank continues with a strategy of keeping the loan portfolio well-diversified across customers & geographies and with a low-ticket size. The bank is primarily present in small & medium ticket size loans, which provides better yield and ease of recoveries in case of defaults. Around 96% of loans are secured as on end-FY20 which is one of the most comforting factors; as it helps in improving collections/recoveries and contain net delinquency. The bank has managed to gain credit market share without diluting much of its credit quality; loan book growth is expected to grow in double digits in FY22-23. DCB Bank also has been able to gradually reduce its loan concentration; top 20 customers now account for a mere 5.1% of loans in end-FY20 vs ~10% in end-FY15. Diversification of the loan book with reduction in concentration risk would improve credit quality in future.





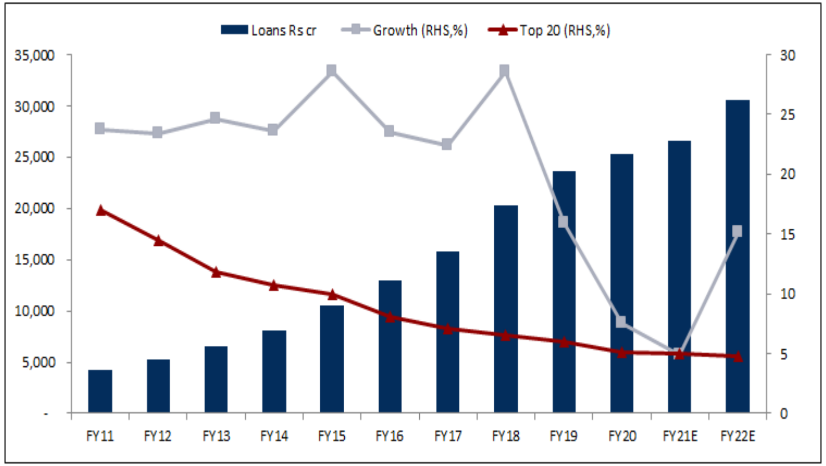
(Source: Company, Hdfc Sec)

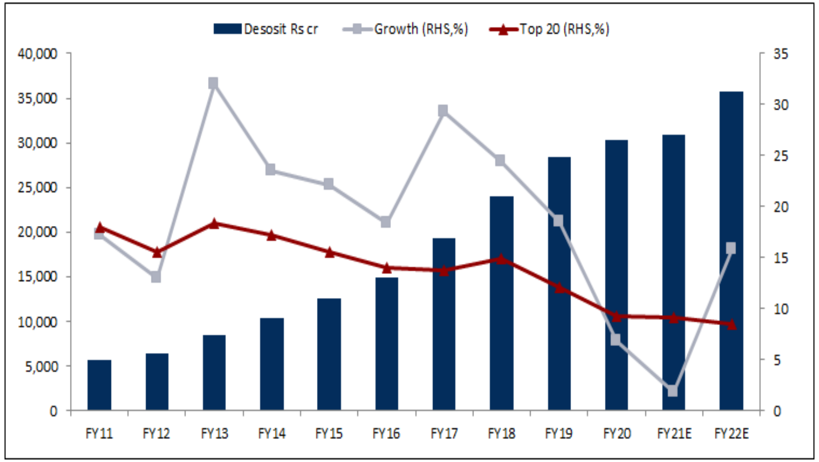
Concentration on Tier-2 to Tier-6 locations – less competition

DCB bank has its presence in the Tier-2-Tier-6 locations where the scope of growth is higher. There are many opportunities to offer simple innovative products backed by superior technology in the Rural and Semi-Urban areas of India. DCB endeavours to cater to underbanked and unbanked population of the country through a wide range of products like zero balance savings account, small recurring deposit account, small loans to match the income and cash flow cycle. Many of its new branches are located in Tier 2 to Tier 6 locations. DCB bank has continued to expand its rural footprint with the main aim of achieving financial inclusion. It offers Micro or small ticket mortgage loans that are most useful for customers in semi-urban and rural areas. Out of 344 branches of the bank as at Sep 30, 2020, about 45% of the branches are located in Semi-urban and rural area.

Increased Granularity in Business:

DCB Bank has been focusing on increasing the granularity of its business, both on the asset and liability side. Higher granularity will definitely help in further re-rating. Over the last 3 years, the composition of Top 20 loans eased to 5.2% from 8.4% earlier. Approximately 85% of loan book ticket size is Rs 3cr or below. Similarly, the composition of Top 20 deposits also eased to 9.3% from 13.8% earlier. There has been sharp drop in reliance on inter-bank deposits, whose share was dropped down from 21% of total deposits as at end-March 2018 to 13% as at end-March 2020. Although the bank has long-term relationships, any redemption pressures of bulk deposits could lead to immediate need for substitute funds from other sources, which could lead to volatility in cost of funds.

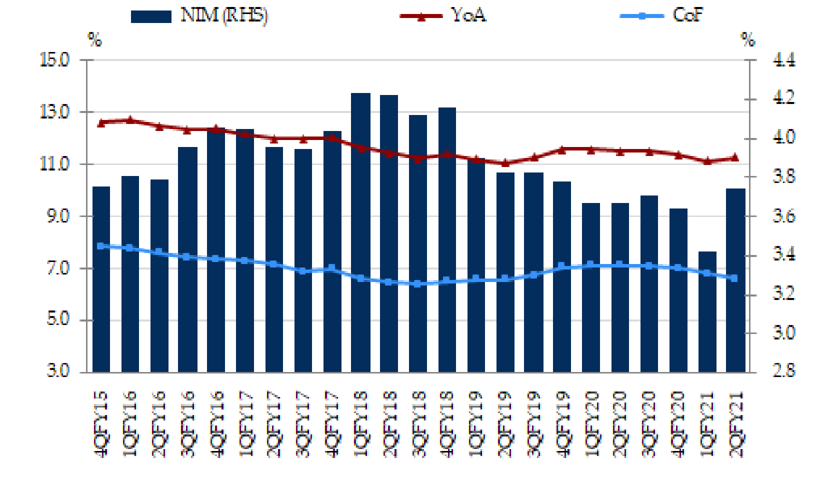


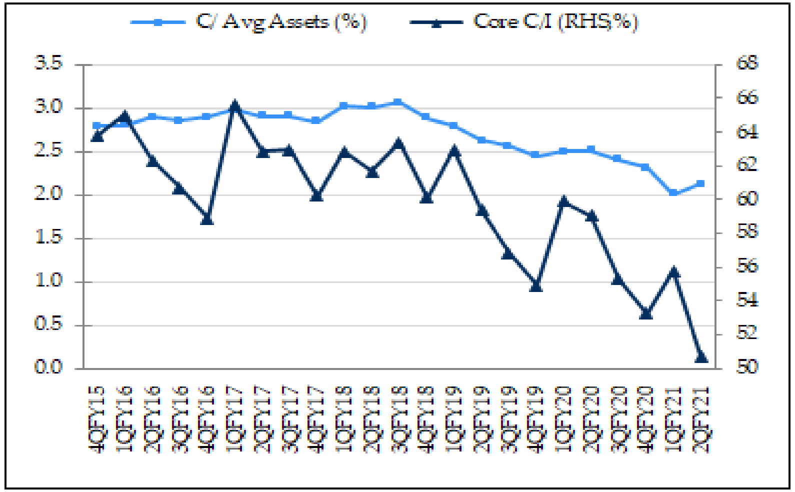


(Source: Company, HDFC Sec)

NIM on Strong footing:

DCB Bank managed to maintain healthy interest margins despite high cost of borrowings. While the bank's cost of interest-bearing funds is higher than some its peers as well as the industry average, the NIMs have remained healthy, primarily supported by higher yielding assets and better asset quality. Its focus on self-employed segment with limited exposure to salaried segment has helped the bank to report higher NIMs. Net interest margins (NIMs)/ average total assets (ATA) ratio remained robust at 3.56% in first half of FY21; marginally less than 3.67% in FY20. With slowing new branch addition and increasing scale of operations, the bank's cost metrics would continue to improve. Going forward, DCB's ability to maintain NIMs by improving its cost of funds and maintain stable asset quality indicators would remain a determinant of its interest margins and would thus be a monitorable. We expect NIMs (calculated) to stay around 3.5-3.55% over FY2021-23E (from 3.6% in FY2020) driven by a reduction in cost of funds driven by a similar decline in both yield on advances and cost of funds. Yields could be under pressure as a result of shift in loan mix towards more retail assets such as vehicle and mortgage loans where competition from other banks and NBFCs is relatively high. Although focus on building a retail deposit franchise (currently at 78% of deposits) will help cushion margins in the medium term as retail deposit costs tend to be relatively inelastic in comparison to loan yields.





(Source: Company, HDFC Sec)

Improving Cost-to-Income Ratio:

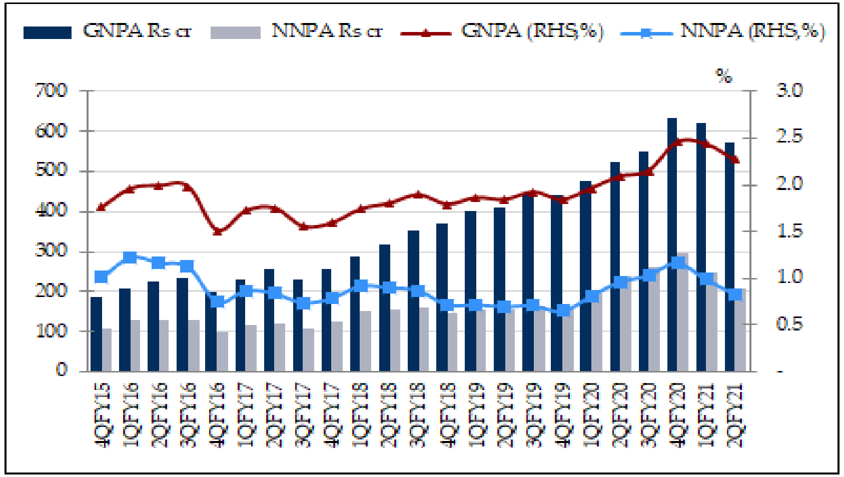
The bank has done well in restricting growth in operating expenses by implementing stringent cost control measures and slowdown in branch/ATM expansion. Cost-income ratio has remained high in the range of 55-60% over the past two years as the bank had aggressively opened branches. The company added only three branches in FY20 compared to 11 in FY19, 56 in FY18 and 64 in FY17. The bank intends to prioritize on improving the efficiency of recently added branches, before adding more branches. Management guides 15-20 branches addition; slower branch expansion would aid in easing opex-assets ratio. The bank's cost-income ratio at 54.5% in FY20 is higher than its midcap peers, we expect easing of the cost-income ratio to ~50-52% over the next two years as branches start operating at full scale.

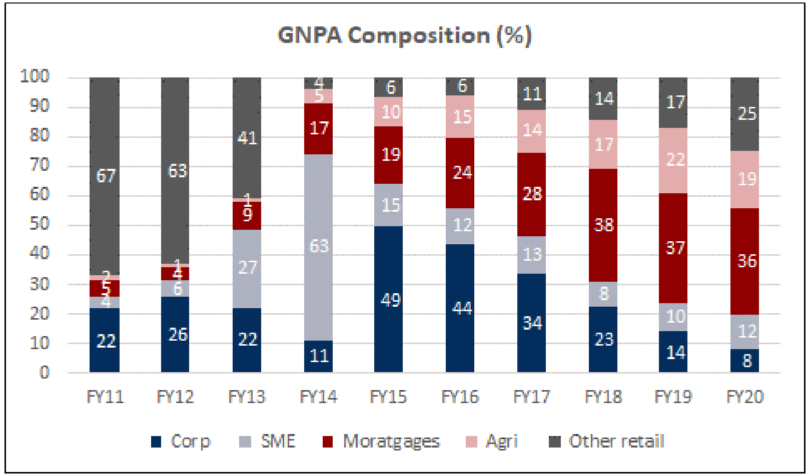
Robust Asset Quality; but needs monitoring:

The asset quality parameter of the bank has been moderate with rise in slippages in last two financial years, especially in mortgage loan segment. Gross NPAs have increased to Rs 631.5cr as on March 31, 2020 from Rs 439.4cr as on March 31, 2019. The bank reported Gross & Net NPA of 2.27% and 0.83% respectively as on Sep 30,2020 (2.46% and 1.16% as at March 2020 end), translating into provision coverage ratio of 64.1% as at Sep 30, 2020. Although, Gross NPA has been gradually inching up; however, it still remains well within reasonable limits considering average loans yields at 11.6% (FY20). Provision coverage is comfortable in excess of 64%.

The mortgages book, comprising loans against property and home loans, formed 42% of advances saw rise in Gross NPAs which was on higher side @2.14% of mortgage loans as at March 2020 (vs 1.73% as at March 2019). The SME (small and medium enterprise) or MSME (micro, small and medium enterprise) and agriculture related segments showed signs of improvement in its gross NPAs to 1.94%, as on September 30, 2020 as compared to 2.49%, same time last year. Corporate advances formed just 10% of total advances as of September 2020. In the corporate book, the exposure is primarily to higher rated corporates with the bank also being able to recover from difficult accounts and with the focus on running a shorter tenure book. Slippages in the Corporate loan segment could however lead to sharp rise in gross NPAs, given the bank's small size. However, granularity in the overall book should help the Bank maintain stable asset quality over the medium term.

The bank has shown stability on asset quality front on the backdrop of disruptions from de-monetization and implementation of GST in the past; reflecting robust underwriting process despite operating in relatively riskier self-employment segment. Exposure to vulnerable sectors like metal, infrastructure and textile is limited. Key reasons for strong credit quality have been disciplined lending, low-ticket size loans, relationship managers' deep engagement with small business loans borrowers and in-house strong collection & recovery teams. Asset quality remains monitorable amid ongoing economic slowdown, given its presence in the self-employed and lower end of the retail borrower segment (including small and medium enterprises; SMEs).





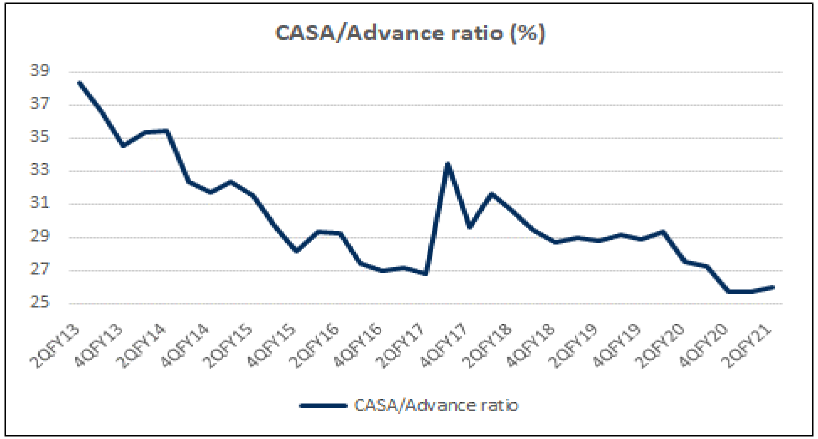
(Source: Company, HDFC Sec)

Comfortable Capital Position:

DCB Bank's healthy capitalisation is reflected in comfortable capital adequacy ratios (CAR), due to strong growth over the years and regular profits. The bank's capital ratios remain comfortable with Tier I and CRAR, as a percentage of risk-weighted assets (RWAs), of 14.22% and 18.28%, respectively, as on Sep 30, 2020 against 13.90% and 17.75%, respectively, as on March 31, 2020. The bank's RWA/total assets has shown a declining trend and was at 60.9% as on Sep 20, 2020; which was 67.8% two years ago. As a result, despite a sharp growth in advances in the last three years, its Tier I capital ratio has remained comfortable. DCB's capital profile also benefits from AKFED's stance that it will extend support as and when required. In the past it has infused capital either directly or through associated entities or has helped the bank raise equity. Maintaining a strong asset quality and earnings profile will remain critical for DCB's ability to raise equity capital in future, particularly given the economic environment, which may pose asset quality pressure. Given DCB Bank's demonstrated ability to raise funds, and considering its growth plans, is expected to maintain comfortable capitalisation levels in the medium term.

Concerns

- **Moderate CASA proportion:** The ratio CASA (as a % of gross advances) has been on a flat to moderating trajectory for past five years, which indicates use of CASA to fund credit has been on a downward trend. CASA (as a % of total advances) stood at 29.6% in end-FY17, which fell to 25.7% in end-FY20, indicating a portion of CASA used to fund credit has reduced. This could impact margins; it could ideally moderate as the use of low-cost CASA to fund credit is gradually declining.



(Source: Company, HDFC Sec)

- **High Cost of Funds:** The cost of funds stood at 6.61% in Q2FY21 is relatively higher compared to other private sector lenders. With the increased focus on term deposits, the share of low-cost current account and savings account (CASA) deposits in the bank's total deposits remained at 22% as on Sep 30, 2020 well below the share of many other peer banks and the overall banking sector average.

- **ALM mismatches:** As per the structural liquidity statement (SLS) as of March 2020, the bank has asset-liability mismatches across most of the time buckets. This is because of the long tenure of its assets while most of the deposits are repayable within three years. As on March 31, 2020, only 18% of the advances mature in the up to 1-year buckets compared to 50% of the deposits, resulting in negative mismatches. During the last few quarters, the bank has continued to focus on improving the granularity of its deposits by offering higher deposit rates for longer tenure. The ongoing focus on the increasing share of term deposits, availing long-term refinance, reducing interbank deposits by increasing the share of retail deposits and likely borrowing will continue to support a reduction in the mismatches

- **Loan book growth - weak**: Loan book growth was flat and is likely to remain subdued in FY21. Management sounded caution on further loan book growth. The Bank intends to focus on Business Loans (LAP), Home Loans, Gold Loans, KCC (Kissan Credit Card), Tractor Loans and short term Corporate Loans. Longer-than-expected breakeven period for the newer branches could affect loan growth trajectory.

- **Slippages in the mortgage book:** Asset quality remains monitorable amid ongoing economic slowdown, given its presence in the self-employed and lower end of the retail borrower segment (including small and medium enterprises; SMEs). Around 85-90% of the borrowers in the mortgage and SME segments represent marginal self-employed borrowers with an average loan ticket size of Rs. 30-35 lakh. Further, loans under the AIB and commercial vehicle (CV) segments and gold loans have an average ticket size of Rs. 1-3 lakh. Increasing delinquency trends in the softer buckets remain monitorable as they could have a bearing on the asset quality metrics.

  The Bank has a long walk on retailisation of liabilities, faces near-term uncertainties emanating from the COVID crisis & resultant higher credit costs over FY21-22.

Company Profile:

DCB Bank (earlier a co-operative bank) was formed by the merger of Ismailia Co-operative Bank Limited and Masalawala Cooperative Bank in 1981. The bank was incorporated in 1995 by reconstituting Development Co-operative Bank Ltd to Development Credit Bank Ltd (DCBL) as a joint-stock banking company. AKFED and its Indian associate, Platinum Jubilee Investments, are the largest shareholders in DCB Bank, with stake at 14.88% as on September 30, 2020. AKFED is an international development agency dedicated to promoting entrepreneurship and building economically sound enterprises in developing economies.

DCB Bank is a private sector bank 344 branches across 18 states and 2 union territories. The bank has created niche in mortgage financing (~40% of total advances) with emphasis on small ticket loans (ticket size ~3-3.5mn) to self-employed in Tier II-VI cities. The portfolio is well diversified with greater reliance on secured lending (~96% of the total loans are secured). DCB Bank's products and services range from loans for Small and medium enterprises and Mid Corporate customers, to Loans for individual needs such as home loan, loan against gold, commercial vehicle loan and small business loan. Agri & Inclusive Banking from DCB Bank includes tractor loan, loan against gold, warehouse finance, loan against warehouse receipt, loans for microfinance organisations amongst other products. The bank is headed by Mr. Nasser Munjee, Chairman, and Mr. Murali M. Natrajan, the MD & CEO of the bank. The bank's advances profile is largely focused on SME and MSME lending and has grown at a CAGR of 19.4% over the last five years. The bank also has a grown its deposit franchise which has grown at a similar CAGR of 19.2% over the last 5 years owing to branch expansion plans.

INCOME STATEMENT

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	2,413	3,041	3,537	3,623	3,923
Interest Expenses	1,418	1,892	2,272	2,348	2,501
Net Interest Income	**995**	**1,149**	**1,265**	**1,275**	**1,422**
Non interest income	310	350	391	390	435
Operating Income	1,306	1,499	1,656	1,665	1,857
Operating Expenses	781	853	903	862	974
PPoP	**525**	**647**	**753**	**803**	**882**
Prov & Cont	139	140	261	387	368
Profit Before Tax	386	507	492	416	514
Tax	141	181	154	105	129
PAT	**245**	**325**	**338**	**311**	**385**

BALANCE SHEET

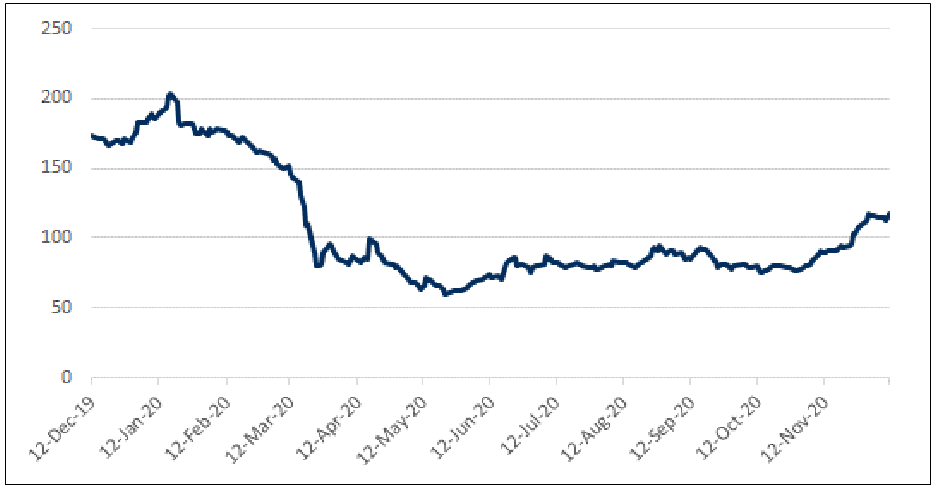
(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
SOURCES OF FUNDS					
Share capital	309	311	311	311	311
Reserves and surplus	2,498	2,805	3,111	3,422	3,788
Shareholders' funds	2,808	3,116	3,422	3,733	4,099
Total Deposits	24,007	28,435	30,370	30,929	35,804
CASA	5,840	6,810	6,519	7,018	7,875
Total Borrowings	1,927	2,723	3,408	3,853	4,055
Other Liabilities, provisions	1,481	1,518	1,305	1,440	1,589
Total	**30,222**	**35,792**	**38,505**	**39,955**	**45,546**
APPLICATION OF FUNDS					
Cash & Bank Balance	2,372	2,793	3,546	3,624	3,999
Investments	6,219	7,844	7,742	7,677	8,670
Advances	20,337	23,568	25,345	26,599	30,612
Fixed Assets	494	526	546	557	571
Other Assets	800	1,060	1,327	1,499	1,694
Total	**30,222**	**35,792**	**38,505**	**39,955**	**45,546**

DCB Bank Ltd.

RATIO ANALYSIS

As at March (Rs cr)	FY18	FY19	FY20	FY21E	FY22E
VALUATION RATIOS					
EPS	8.0	10.5	10.9	10.0	12.4
Earnings Growth (%)	22.9	32.6	3.9	-7.9	23.6
BV	91.1	100.6	110.2	120.2	132.0
ABV	78.2	87.8	93.1	94.2	115.2
RoAA (%)	0.9	1.0	0.9	0.8	0.9
ROAE (%)	9.8	11.0	10.3	8.7	9.8
P/E (x)	14.7	11.1	10.7	11.6	9.4
P/ABV (x)	1.5	1.3	1.3	1.2	1.0
PROFITABILITY					
Yield on Advances (%)	10.7	11.2	11.6	11.3	11.2
Yield on Investment (%)	7.0	7.6	8.0	7.9	7.8
Cost of Deposits (%)	6.0	6.5	6.9	6.7	6.6
Core Spread (%)	4.8	4.6	4.7	4.6	4.6
NIM (%)	3.8	3.6	3.6	3.4	3.5
OPERATING EFFICIENCY					
Cost/Avg. Asset Ratio	2.9	2.6	2.4	2.2	2.3
Cost-Income Ratio (%)	61.9	58.4	56.8	55.6	55.3
BALANCE SHEET STRUCTURE RATIOS					
Loan Growth (%)	28.6	15.9	7.5	4.9	15.1
Deposit Growth (%)	24.5	18.4	6.8	1.8	15.8
C/D Ratio (%)	84.7	82.9	83.5	86.0	85.5
CASA (%)	24.3	23.9	21.5	22.7	22.0
Total Capital Adequacy Ratio (CAR)	16.5	16.8	17.8	17.2	16.3
Tier I CAR	12.7	13.1	13.9	13.7	13.3
ASSET QUALITY					
Gross NPLs (Rs cr)	369.0	439.5	631.5	1,133.6	858.2
Net NPLs (Rs cr)	146.7	153.8	293.5	571.3	284.7
Gross NPLs (%)	1.8	1.8	2.5	4.1	2.7
Net NPLs (%)	0.7	0.7	1.2	2.1	0.9
Coverage Ratio (%)	60.2	65.0	53.5	49.6	66.8
Provision/Avg. Loans (%)	0.7	0.6	0.7	1.5	1.2

One Year Stock Price Chart



(Source: Company, HDFC sec)

Disclosure:

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