



Initiating Coverage

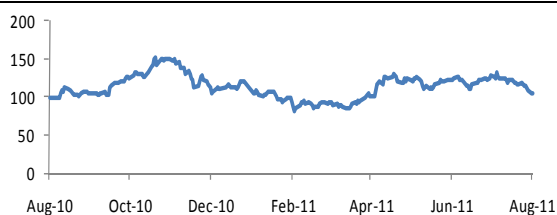
Development Credit Bank Ltd

Recommendation	BUY
CMP (10/08/2011)	Rs. 52
Target	Rs. 68
Sector	Banking

Stock Details

BSE Code	532772
NSE Code	DCB
Bloomberg Code	DEVB IN
Market Cap (Rs. Crs)	1,149
Free Float (%)	76.92
52- wk HI/Low	77/39
Avg. volume BSE (Quarterly)	11,24,580
Face Value (Rs.)	10
Dividend (FY 2011)	NIL
Shares o/s (in Crs)	20.15

Relative Performance	1 Mth	3 Mth	1 Yr
DCB	-10.6%	-9.0%	-7.8%
Sensex	-18.2%	-15.2%	5.2%



Shareholding Pattern as on 30/06/2011

Promoters Holding	23.08%
FII, Banks & Institutions	13.60%
Corporate Bodies	13.37%
Public & others	49.95%

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Snapshot

Headquartered in Mumbai, Development Credit Bank (DCB) is a small new generation private sector bank with offerings in retail, SME and corporate banking segments. DCB has a network of 80 branches, 134 ATMs and approximately 600,000 customers as on FY11. The total business (advances and deposits) of the bank stands at Rs 10,214 crs as on 30 June 2011 and has balance sheet size of Rs 7,372 crs as on 31 March 2011.

Investment Rationale

Strong and experienced new Management

Mr Murali Natrajan joined DCB in April 2009. He, along with his team initiated the turnaround process. The bank adopted a consolidated phase in order to strategically change its business model. DCB has evolved from a stressed, loss making bank in FY09 to a profitable and a new generation private sector bank in FY11 after a challenging two years of restructuring under the guidance of its new Management.

Focus on retail liabilities than wholesale liabilities:

DCB's near term focus is to ramp up its CASA franchise by increasing its CASA per branch. Continuing with its focus on liabilities strategy, DCB's CASA deposits are likely to outpace overall deposits growth over FY11-13E. However, given the current tight liquidity environment, we expect NIMs to decline from 3.1% in FY11 to 2.8% for FY12 and then increase marginally to 2.9% in FY13.

Improving cost efficiency:

With strong business growth over FY11-13E, investment in employees and distribution & technology now in place, we expect DCB's cost-efficiency to gradually trend towards peer average over the next two years. We expect 12.3% CAGR in operating costs over FY11-13E and expect its cost-to-income ratio to improve from 71.4% in FY11 to 70.7% for FY12E and 67.4% in FY13E.

Improvement in NPA ratios:

The bank's exit from unsecured retail lending and focuses on secured credit lines like mortgages, MSME, etc. makes its loan portfolio less vulnerable to fresh slippages. We expect the bank's Gross NPAs to come down to 4.71% in FY12E and 3.63% in FY13E and Net NPAs to come down to 0.98% in FY12E and 0.74% in FY13E. The credit cost is also likely to come down from 1.3% in FY11 to 0.8% and 0.7% in FY12E and FY13E.

Valuation & Recommendation

At CMP of Rs. 52, the stock is trading at 1.62x of its FY12E ABV and 1.47x its FY13E ABV. Looking at the historical trend and DCB's turnaround story we value it at 2.1x P/ABV of FY12E. Based on our estimated book value of Rs.32.2 per share for FY12E and P/ABV target multiple of 2.1x we arrive at a target price of Rs.68. **We recommend BUY on the stock with target price of Rs.68 indicating a potential upside of 31%**

Year	NII (Rs crs)	Growth %	Profit before provisioning (Rs. Crs)	Margin %	PAT (Rs. Crs)	EPS (Rs)	P/E (x)	Adj. BVPS (Rs.)	P/ABV (x)	ROE %
FY 10A	142	-28.2%	48	8.5%	(78)	(3.92)	(13.25)	23.5	2.21	-14.5%
FY 11A	189	33.6%	86	13.3%	21	1.07	48.72	26.9	1.94	3.9%
FY 12E	212	12.2%	95	12.2%	46	2.30	22.62	32.2	1.62	6.6%
FY 13E	258	21.4%	131	13.8%	74	3.67	14.16	35.4	1.47	8.5%

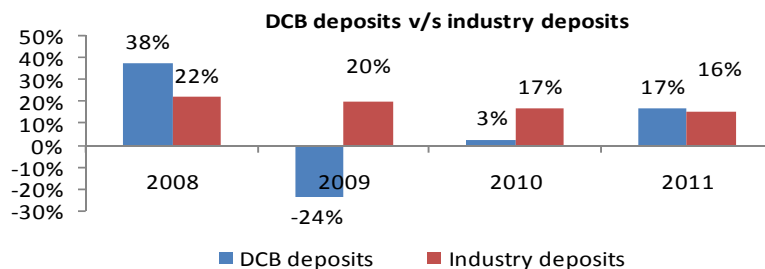
Investment Rationale

Problems faced by DCB: During FY06-FY08, DCB had focused heavily on unsecured and personal-loan book resulting in high exposure to risky and unsecured assets which went to 41% of total loan book. The loan book growth was much faster (at 53% in FY08) as compared to 38% in deposits over the same time. In order to keep in pace with the advance growth the bank had to shift its focus from CASA to wholesale and bulk deposits. This started to put pressure on net interest margins (NIMs) and overall profitability. Resulting from the global slowdown, delinquencies started increasing which wiped out the company's profits in FY09 and FY10. The gross NPA ratio increased to a high of 8.9% in FY09 and 8.7% in FY10, compared to 1.6% for FY08.

Turnaround strategy adopted by new Management:

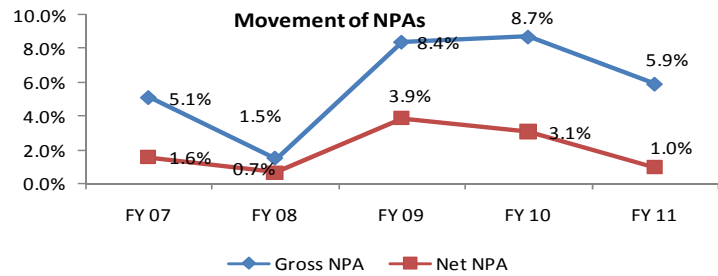
Strong and experienced new Management: Mr Murali Natrajan joined DCB as CEO in April 2009. Prior to this, he was the global head for SME banking at the Indian operations of Standard Chartered Bank (StanChart). Mr Natrajan has been a consumer banking professional with over 20 years of experience in India, Singapore, Hong Kong, Korea and Indonesia. He, along with his team, initiated the turnaround process with the main focus on bank's liability base. Under his leadership, the following corrective steps were taken:

- ❖ *Management emphasized on reshuffling of asset base from risky unsecured loans to secured loans and focus on asset book growth.*
- ❖ *The bank adopted a consolidated phase in order to strategically change its business model. As its balance sheet was impacted by unsecured loans on one hand and pressurized by high cost bulk deposits on the other hand; DCB had to reduce its asset base in order to transform its balance sheet components.*



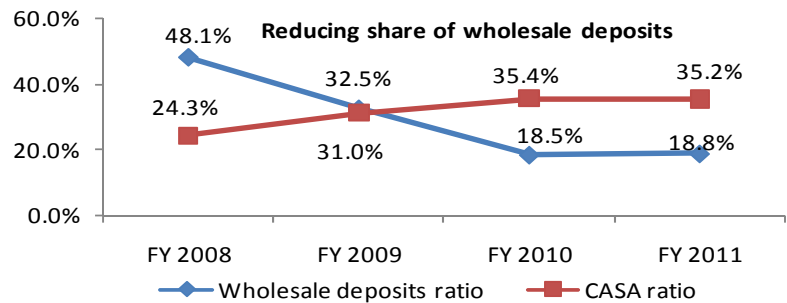
Source: Company data, Nirmal Bang Research

- ❖ *Management wrote off the entire bad loans in a process to clean up its balance sheet.*



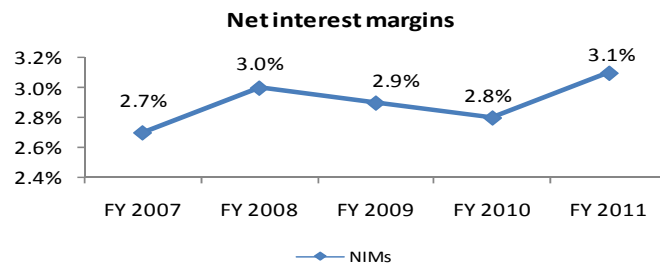
Source: Company data, Nirmal Bang Research

- ❖ On the liability front, dependency on wholesale deposits was reduced and more emphasis was given on low cost deposits to improve its CASA.



Source: Company data, Nirmal Bang Research

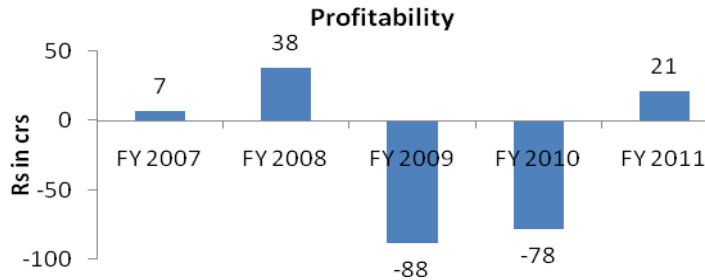
- ❖ Focus on CASA led to an increase in net interest margins for the bank.



Source: Company data, Nirmal Bang Research

- ❖ Management targeted to reduce the cost base in order to drive cost efficiencies and reduced the headcount drastically.
- ❖ Focus on non interest income of the bank by improving bank's transaction banking services and emphasizing on its insurance distribution division which would help the bank to increase its contribution from non interest income.

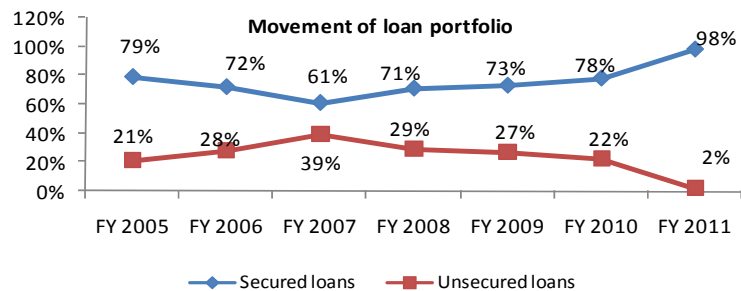
DCB has evolved from a stressed, loss making bank in FY09 to a profitable and a new generation private sector bank in FY11 after a challenging two years of restructuring and consolidation of business under the guidance of its new Management.



Source: Company data, Nirmal Bang Research

Reduction in exposure to risky asset classes:

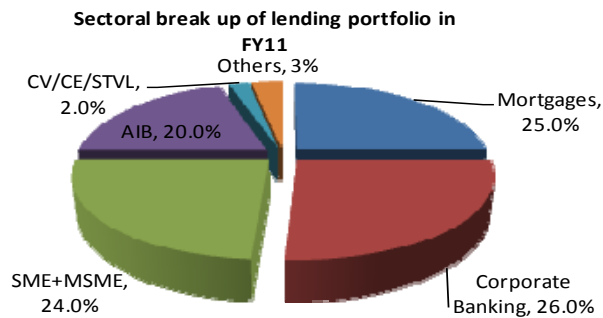
DCB stopped disbursing unsecured personal loans and constantly made efforts to reduce its exposure to unsecured and risky personal loan book. Total unsecured personal loan book as on 31 March 2011 stands at Rs 136 crs out of which 7 crs is good and the remaining 129 crs have been provided for on a 100% basis. Personal loan book stands at 0.2% of the bank's total loan book in FY11. Similarly, DCB put a squeeze on its commercial vehicle (CV) loan disbursals over the last few quarters and the proportion of CV loans reduced to 6% of loan book (Rs 200 crs) in FY10 and 2% in FY11, from 10% in FY08. We believe that going forward; proportion of personal loan and CV book will continue to remain lower which will help the bank to concentrate more on secured loan portfolio.



Source: Company data, Nirmal Bang Research

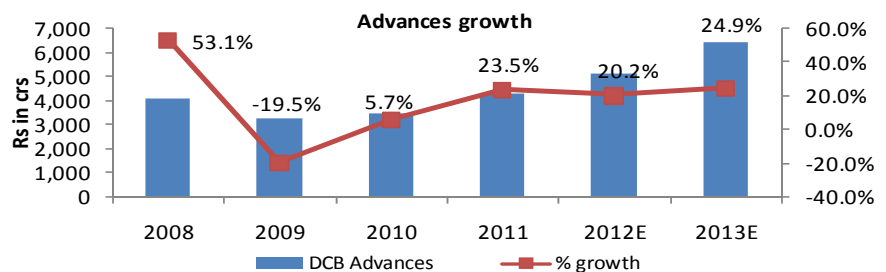
Shift towards retail and SME business:

Since FY10, DCB has returned back on growth track, even after reducing its exposure to personal and CV loan books. The main reason behind this is that DCB has shifted its focus towards mortgage, mid-corporate, micro-SME, SME, agriculture and priority sector. The bank registered loan book growth of 23.5% YoY for FY11 after reporting a decline of 19.5% in FY09 and a marginal growth of 5.7% in FY10. The bank wants to continue to focus on its retail mortgages and SME business.



Source: Company data, Nirmal Bang Research

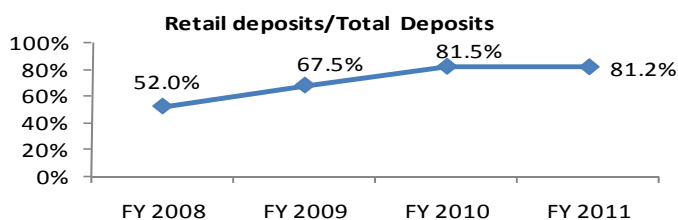
Management expects composition of its loan book to undergo a change with a bias towards SME & MSME advances from 24% in FY11 to 40% by FY13 and continue to focus on mortgages portfolio to keep its share at 25%. Going forward, we expect bank will continue to focus on improving the quality of its loan book rather than ramping up its quantum. We expect DCB to grow its loan book by 20% and 25% in FY12E and FY13E respectively.



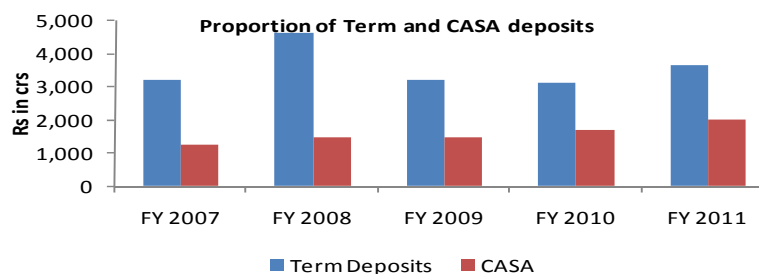
Source: Company data, Nirmal Bang Research

Focus on retail liabilities than wholesale liabilities

On the liabilities front, Management has reduced the bank's 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 CASA ratio has increased to 35.2% for FY11 compared to 30.9% for FY09. The share of retail term deposits has been maintained at 81.2% over the same period. CASA have been increasing in absolute terms, despite the fact that the deposits have not increased at the same pace (CASA grew 17.5% in FY10 compared to an overall growth of 3% in total deposits). Consequently, proportion of wholesale deposits dropped from 47% in FY08 to 18.8% in FY11.

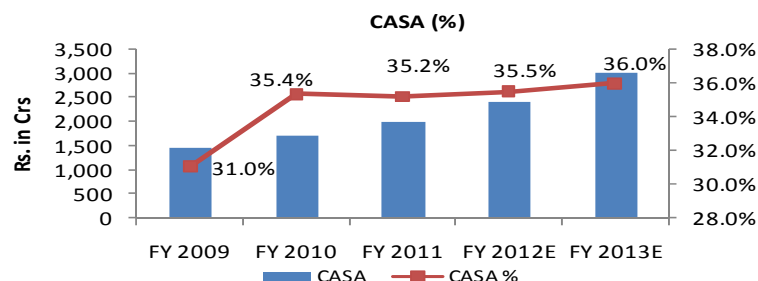


Source: Company data, Nirmal Bang Research



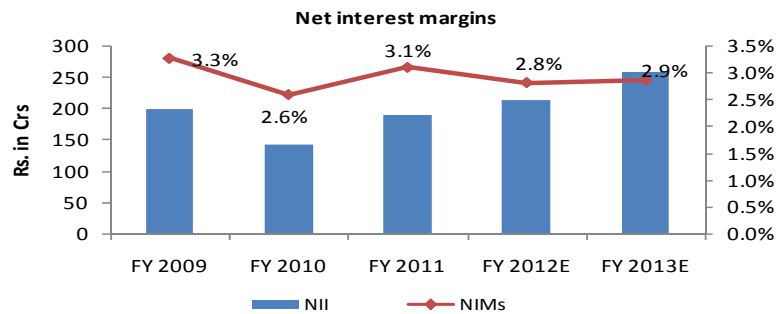
Source: Company data, Nirmal Bang Research

DCB's near term focus is to ramp up its CASA franchise and it intends to increase its CASA per branch from current Rs 23 crs to Rs 35-Rs 38 crs in the next few quarters. Continuing with its focus on liabilities, the bank's CASA deposits are likely to outpace its overall deposits growth over FY11-13E. Led by an estimated 23% CAGR in CASA over FY11-13, we expect the banks CASA share to total deposits to improve to 36% in FY13E from 35% in FY11. We estimate overall deposits CAGR of 22% over the same period.



Source: Company data, Nirmal Bang Research

Increase in CASA will not only help bank to reduce dependence on wholesale borrowings, it will also help DCB to protect its NIM. Following this strategy, the bank has been successful in raising its NIM even when the yield on advances was consistently declining, as it was able to control its cost of funds by changing its liability mix significantly, i.e reducing high cost bulk deposits and focusing on CASA. DCB's NIM improved from 2.6% in FY10 to 3.0% in FY11. However, given the current tight liquidity environment, Management expects its NIM's to contract by 20 to 25 bps and stabilize at around the 2.7%-2.8% level for FY12E. Consequently, we expect NIMs to be at 2.8% in FY12E and then improve increase marginally to 2.9% in FY13E.

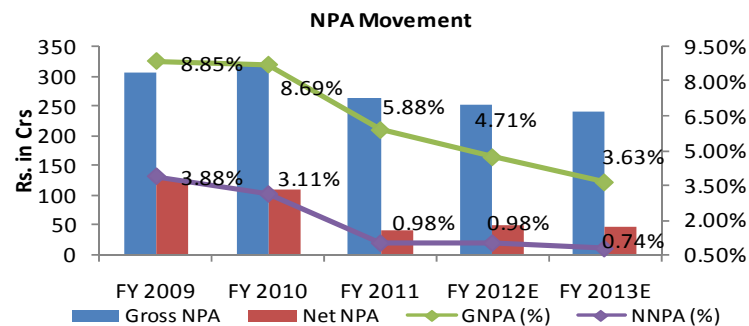


Source: Company data, Nirmal Bang Research

Improvement in NPA ratios:

DCB's efforts on credit cost management started yielding results as the Gross and net NPA ratios started coming down over the last two years. Gross NPAs have come off from a peak of 11.2% in Q2FY10 to 5.86% in FY11, while Net NPAs have come down from 5% in 1QFY10 to 0.97% in FY11. Provision coverage ratio now stands at 87.6% in FY11. DCB has aggressively written off all its non-performing assets including a big ticket delinquent account.

We believe that the bank's exit from unsecured retail lending and continuous focus on secured credit lines like mortgages, MSME, etc. makes its loan portfolio less vulnerable to fresh slippages. Although the bank has maintained higher provisions which dented its profits, we expect the asset quality to steadily improve and, consequently expect provisioning to come down. We expect the bank's Gross NPAs to come down further to 4.71% and 3.63% in FY12E and FY13E respectively and Net NPAs to come down to 0.98% and 0.74% in FY12E and FY13E respectively.



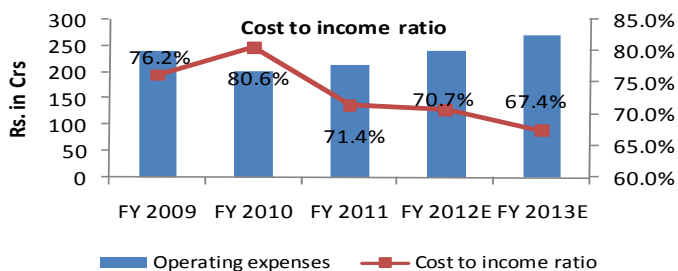
Source: Company data, Nirmal Bang Research

Improving cost efficiency:

DCB's cost-to-income ratio has stayed in the 75-80% range over the last two years on account of decline in net revenue resulting from balance sheet cleaning. Although the bank reduced its headcount in order to contain its cost to income ratio, the depressing total income led to higher cost to income ratio at 81% in FY10.

The Bank does not have aggressive branch expansion plans in the immediate future, but Management targets achieving a 150-strong branch network by FY13E. The recent approval received by RBI for 10 new branches reflects the confidence shown in the new Management. The bank has received branch license after a period of 2 years.

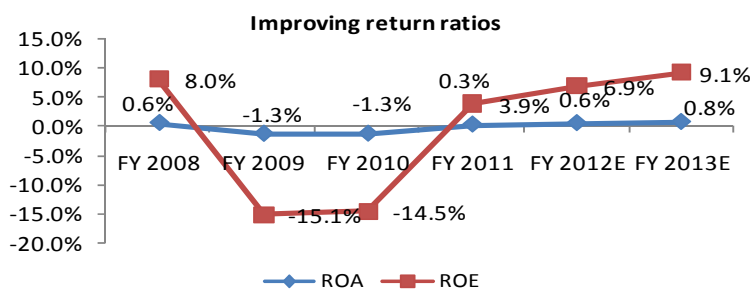
Management expects its operating expenses to increase by less than 10% over the next two years and has set a target of bringing down its cost to income ratio below 60% by FY13E. With strong business growth over FY11-13E, investment in employees, and distribution and technology now in place, we expect DCB's cost-efficiency to gradually trend towards peer average over the next two years. We expect 13.7% CAGR in operating costs over FY11-13E and expect its cost-to-income ratio to improve to 70.7% for FY12E and 67.4% in FY13E.



Source: Company data, Nirmal Bang Research

Return ratios to improve on the back of profitability:

The bank has returned back to profitability in FY11. We believe that this will improve the return ratios for the bank, which have been in the red since FY09. We are positive on the bank's ability to strengthen its core business performance and fee income and lowering of operating costs which would drive the profits of the company. Moreover, high provisioning, which had dented the banks profits in FY09 and FY10 would be scaled down as asset quality improves by FY13E. Management intends to reach 1% RoA by end of FY13. We believe that the returns of the bank will improve with RoA at 0.8% and RoE at 9.1% in FY13E.



Source: Company data, Nirmal Bang Research

Capital raising to further improve capital adequacy

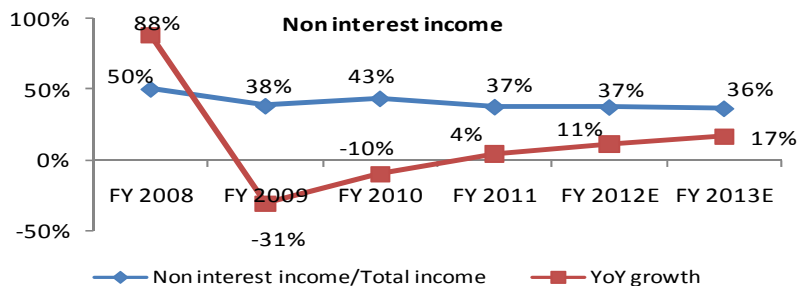
Capital adequacy of the bank stands at 13.25% at present, with tier-1 capital comprising 11.1% of risk-weighted assets. However, promoter holding in the Bank is very high at 23%, which is against RBI’s norm of “no corporate entity having more than 10% stake in any Indian bank”. According to Management, the RBI has allowed the bank till FY14 to reduce its promoter stake to 10%. Therefore DCB is planning to raise capital via QIP. It has got the approval from RBI to dilute equity by way of QIP of Rs 300 crs. However, the bank is planning to raise only Rs 160-170 crs via QIP in this financial year as the Management feels that this will be sufficient for them to grow their balance sheet at 20% in FY12E.

We have assumed in proposed QIP for the bank of Rs 160 crs at Rs 50 per share which leads to 14% dilution in equity for the bank.

Focus on non-interest income streams

DCB has renewed its focus on non-interest income streams, after reporting decline in fee income of 9% in FY09 and 13.5% in FY10. In terms of third-party distribution income, DCB has tied up with Birla Sun life for selling its life insurance products. DCB has also teamed up with ICRA for wealth management product, which would generate backend fees for the bank.

On the non-funded side, DCB has maintained a very good relationship with micro-SME, SME, Mid-corporate and trade-related customers. During FY08-09, DCB centralized many of the trade-finance-related products for better cost efficiency. This adversely impacted its ability to address the local needs, and affected cash management and trade finance income streams. DCB has again decentralized its trade-finance channel and given its branches more flexibility to push customized products. We expect these initiatives to drive 14.0% CAGR in fee income growth over FY11-13E.



Source: Company data, Nirmal Bang Research

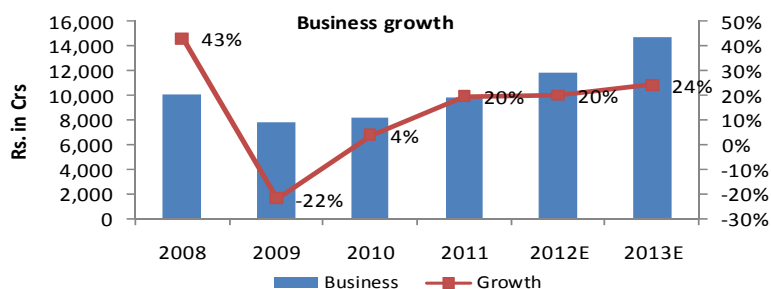
Risk Concerns

- In the event of the macro-economic scenario worsening again, there is a possibility of higher-than-expected NPA provisions.
- Slower-than-expected ramp-up in branch network or CASA deposits could have a significant impact on NIMs and hence the return ratios.
- More than expected slippages from the retail segment can have an impact on the company’s valuation and impact our target price.
- A change in management could impact the bank’s strategic intent leading to another phase of uncertainty for the bank.

Company Background

Headquartered in Mumbai, Development Credit Bank (DCB) is a small new generation private sector bank with offerings in retail, SME and corporate banking segments. DCB has a network of 80 branches, 134 ATMs and approximately 600,000 customers as of FY11. It spans across 10 states in the country, with a concentrated presence in the western states of Goa, Gujarat and Maharashtra. It got listed on the Indian stock exchanges in 2006. DCB was founded in 1930 as a co-operative bank and was converted into a scheduled commercial bank on May 31, 1995 by its promoter – the Aga Khan Fund for Economic Development (AKFED) – which holds +23% stake in the Bank. AKFED operates as a network of affiliates comprising 90 separate project companies.

DCB has a balance sheet size of Rs. 7,372 crs with a total business (advances & deposits) of Rs. 9,882 crs as on 31st March 2011.



Source: Company data, Nirmal Bang Research

Peer Comparison

We are comparing DCB with ING Vysya Bank and Yes Bank. The valuation ratios seem to be higher and the return ratios seem to be low as compared to the other private sector banks. However, the key point to focus on is the quantum of improvement and size of the bank. We believe that good quality management of DCB with small base size will take it to higher growth trajectory. Therefore, we believe that the worst is behind for the bank and profitability ratios can only improve from here on. On P/ABV, DCB is broadly in line with peers.

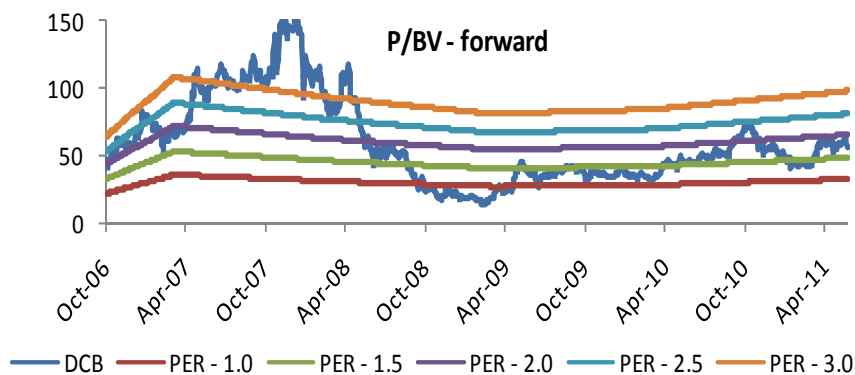
	DCB	ING Vysya	Yes Bank
EPS (Rs)	2.3	29.0	25.4
Adj BV (Rs)	32.0	265.0	131.8
P/E (x)	22.4	11.7	11.5
P/ABV (x)	1.6	1.3	2.2
RoE (%)	6.9%	13.0%	21.9%

* Based on Nirmal Bang estimates for FY12

Valuation and Recommendation

We expect DCB to significantly improve its core operating metrics over the next couple years, driven by transformation as discussed above. We expect the improvement efforts of the bank to continue over the next couple of years which would drive the banks growth going forward. We expect total income to grow at a CAGR of 15.7% over next couple of years. We also expect DCB's operational restructuring to drive traction on fee income streams and improve cost efficiency. The anticipated reduction in cost to income ratio is expected to lead to a 24% CAGR growth in profit before provisions. Given that we expect provisions to decline going forward, we believe that Bank's net profit is likely to grow at a CAGR of 85% over FY11-FY13E. This is also expected to significantly improve the RoE and RoA for the bank. We have factored in proposed equity dilution for the bank of Rs 160 crs and have assumed a price of Rs 50 per share for our calculation purpose.

The stock, which was historically trading at higher than 4x its one year forward ABV till January 2008, slid to 2.5x in mid FY09 and crashed to below 1.5x towards the end of FY 09. With the bank returning to profitability on the back of a revamped business mix, we believe the stock, should command a higher multiple. At CMP of Rs. 52, the stock is trading at 1.62x of its FY12E ABV and 1.47x its FY13E ABV. Looking at the historical trend and DCB's turnaround story we value it at 2.1x P/ABV of FY12E. Based on our estimated book value of Rs.32.2 per share for FY12E and P/ABV target multiple of 2.1x we arrive at a target price of Rs.68. **We recommend BUY on the stock with target price of Rs.68 indicating a potential upside of 31%**



Source: Company data, Nirmal Bang Research

Initiating Coverage

Development Credit Bank Ltd

Financials

Profitability (Rs. Crs)	FY 2010	FY 2011	FY 2012E	FY 2013E
Interest earned	459	536	654	806
Interest expended	317	347	442	549
Net interest income	142	189	212	258
Non interest income	108	112	125	145
Total income	249	301	337	403
Operating expenses	201	215	241	272
Staff costs	88	106	122	140
Other Op Exp	113	109	120	132
Profit before prov	48	86	95	131
Provisions	121	57	41	45
Profit before tax	-73	29	55	86
Taxes	6	8	9	13
Net profit	-78	21	46	74

Quarterly (Rs. Crs)	Sept. 10	Dec. 10	Mar.11	June.11
Net interest income	46	49	50	52
Non interest income	27	26	29	23
Total income	73	75	79	75
Operating expenses	52	55	57	59
Operating profit	21	21	22	17
Provisions	15	9	8	8
Profit before tax	6	11	14	9
Taxes	1	3	3	0
Net profit	5	8	11	9

Profitability Ratios	FY 2010	FY 2011	FY 2012E	FY 2013E
Cost / Income Ratio	80.6%	71.4%	70.7%	67.4%
Net profit margin	(31.5%)	7.1%	13.7%	18.2%
RONW	(14.5%)	3.9%	6.6%	8.5%

Growth Ratios	FY 2010	FY 2011	FY 2012E	FY 2013E
Advances growth	5.7%	23.5%	20.2%	24.9%
Deposit growth	3.0%	17.2%	20.1%	23.9%
NII growth	(28.2%)	33.6%	12.2%	21.4%
PAT growth	N/A	N/A	115.1%	59.8%
Pre prov profit growth	(36.0%)	78.2%	10.8%	37.8%
Non interest inc growth	(10.5%)	4.2%	11.2%	16.6%

Ratios	FY 2010	FY 2011	FY 2012E	FY 2013E
P/BV	1.92	1.84	1.55	1.41
P/ABV	2.21	1.94	1.62	1.47
P/E	-13.25	48.72	22.62	14.16

Balance Sheet (Rs. Crs)	FY 2010	FY 2011	FY 2012E	FY 2013E
Deposits	4,787	5,610	6,736	8,346
(of which CASA)	(1,693)	(1,976)	(2,391)	(3,004)
Borrowings	504	861	870	905
Other liab and prov	245	280	322	370
Total liabilities	5,536	6,751	7,929	9,621
Equity capital	200	200	232	232
Reserves and surplus	399	419	593	666
Net worth	599	619	825	898
Total liab and equity	6,137	7,372	8,753	10,519
Cash and bank bal	332	487	515	303
Investments	2,018	2,295	2,756	3,430
Advances	3,460	4,271	5,136	6,414
Fixed assets	136	128	147	161
Other assets	191	191	201	211
Total assets	6,137	7,372	8,753	10,519

Key Ratios	FY 2010	FY 2011	FY 2012E	FY 2013E
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Yield Ratios				
Avg Yield on Assets	8.4%	8.4%	8.7%	8.9%
Yield on Advances	10.7%	10.4%	10.6%	10.6%
Yield on Investments	5.2%	6.1%	6.2%	6.2%
Cost of Int Bearing Liab	6.2%	5.9%	6.3%	6.5%
Cost of Deposits	6.2%	5.5%	5.9%	6.2%
Net Interest Spread	2.2%	2.5%	2.4%	2.4%
NIM	2.6%	3.1%	2.8%	2.9%

Balance Sheet Ratios				
Gross NPA	8.69%	5.88%	4.71%	3.63%
Net NPA	3.11%	0.98%	0.98%	0.74%
Return on Assets	-1.3%	0.3%	0.6%	0.8%
CASA	35.4%	35.2%	35.5%	36.0%
Loan-deposit ratio	72.3%	76.1%	76.2%	76.9%
CAR	14.9%	13.3%	16.4%	14.1%
Dividend yield	0.0%	0.0%	0.0%	0.0%

Valuation Ratios	FY 2010	FY 2011	FY 2012E	FY 2013E
EPS	-3.92	1.07	2.30	3.67
BVPS	27.1	28.2	33.6	36.8
Adjusted BVPS	23.5	26.9	32.2	35.4

Source: Company data, Nirmal Bang Research

NOTE

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