DCB Bank

19 October 2018

Reuters: DCBA.NS; Bloomberg: DCBB IN

2QFY19 Result Update

DCB A Key Beneficiary Of NBFC upheaval

DCB Bank (DBL) reported 2QFY19 results with the key pointers being: (1) DBL is a key beneficiary of the NBFC sector crisis since it is in direct competition with NBFCs with ~80-85% of clients from the Self Employed segment. This is positive for (a) loan growth as well as (b) yield on loans (2) Caution on mortgages segment is being more than offset by faster growth in Agri & Inclusive Banking (AIB), SME and commercial vehicle (CV) finance, resulting in overall loan growth of 27% YoY (3) NIM contracted 7 bps QoQ to 3.83% due to decline in yield on loans but (a) MCLR resets and (b) increasing pricing power will have a salutary impact prospectively. (4) Opex control outcome is encouraging with cost to income ratio declining 138 bps QoQ to 58.88% (See *comprehensive* conference call takeaways on page 2; See initiating coverage report: click here). Per se, on the results front, DBL posted NII growth of 14% YoY to Rs2,818mn, PPOP growth of 18% YoY to Rs1,461 and PAT growth of 25% YoY to Rs734mn. We have revised our estimates for FY19/FY20/FY21 and retained Buy rating on DBL, revising our target price to Rs207 (from Rs200 earlier) and valuing the stock at 1.5x 1HFY21E P/BV.

DBL is a key beneficiary of the NBFC sector crisis since it is in direct competition with NBFCs with ~80-85% of clients from the Self Employed segment: On the conference call, management stated that, since the NBFC sector crisis, they are witnessing lower competitive intensity. Management stated that 80-85% of clients both on the loan and liability side belong to the Self Employed segment, the key target set for NBFCs. Easing competitive pressure is also expected to provide pricing power to DBL, as per management.

Caution on mortgages segment is being more than offset by faster growth in AIB, SME and CV finance, resulting in overall loan growth of 27% YoY: Bread and butter mortgages segment grew 21% YoY and still forms 40% of loan book. The relative slack was picked up in the AIB, SME and CV finance segments which grew 42%, 78% and 27% YoY, respectively and now form 19%, 7% and 12% of total loan book, respectively. DBL management broadly re-iterated that the bank remains on track to double their balance sheet in 3-4 years.

NIM contracted 7 bps QoQ to 3.83% due to decline in yield on loans but (MCLR resets and increasing pricing power will have a salutary impact prospectively: Yield on loans fell 14 bps YoY to 11.07% due to competitive pressure and was the key contributor to the decline in NIM. Impact of MCLR hikes will be felt prospectively on the reset dates. Increasing pricing power is also likely to result from the vacating of space by NBFCs. Interestingly, cost of funds only inched up 1 bp QoQ to 6.59%. Management explained that the systemic liquidity crisis only emerged towards the fag end of 2QFY19 and impact may be felt in 3QFY19. Management also explained that interbank term deposits (20% of total) are not necessarily higher cost than retail term deposits for DBL. Management guided that NIM would be maintained between 375-385 bps over 2HFY19.

Opex control outcome is encouraging with cost to income ratio declining 138 bps QoQ to 58.88%: Accelerated branch expansion phase had spillover impact running into 1QFY19 due to continued personnel recruitment and other costs. However, 2QFY19 is the first indication of a lower opex regime for DBL, which augurs well from an RoE expansion perspective. DBL has not yet officially revised lower its target for an exit RoE of 14% in 4QFY19.

Valuation and outlook: We have marginally revised our NII estimates by 0.4%/1%/0.6%, PPOP estimates by 0.6%/1.5%/0.7% and PAT estimates by 0.5%/1.4%/0.5% for FY19/FY20/FY21, respectively. We have retained Buy rating on DBL, valuing the stock at 1.5x 1HFY21E P/BV and revising our target price to Rs207 (from Rs200 earlier).

BUY

Sector: Banking

CMP: Rs160

Target Price: Rs207

Upside: 29%

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Key Data

Current Shares O/S (mn)	309.2
Mkt Cap (Rsbn/US$mn)	49.5/672.2
52 Wk H / L (Rs)	207/140
Daily Vol. (3M NSE Avg.)	1,825,341

Price Performance (%)

	1 M	6 M	1 Yr
DCB Bank	(2.2)	(19.6)	(10.2)
Nifty Index	(7.3)	(0.7)	2.4

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	2QFY18	1QFY19	YoY (%)	QoQ (%)
Interest income	7,357	5,870	7,014	25.3	4.9
Interest expenses	4,538	3,389	4,285	33.9	5.9
Net interest income	**2,818**	**2,481**	**2,730**	**13.6**	**3.2**
NIM (%)	***3.8***	***4.2***	***3.9***	***(39bps)***	***(7bps)***
Non-interest income	735	653	828	12.6	(11.3)
Operating income	**3,553**	**3,134**	**3,558**	**13.4**	**(0.1)**
Staff costs	1,102	921	1,087	19.6	1.4
Other operating expenses	990	969	1,057	2.2	(6.3)
Total operating expenses	2,092	1,890	2,144	10.7	(2.4)
Cost- to-income (%)	*58.9*	*60.3*	*60.3*	*(143bps)*	*(138bps)*
Pre-provision profit	**1,461**	**1,244**	**1,414**	**17.5**	**3.3**
Provisions	319	302	332	5.5	(4.0)
PBT	**1,142**	**942**	**1,082**	**21.3**	**5.6**
Tax	408	353	387	15.5	5.4
-Effective tax rate	35.7	37.5	35.8	*(179bps)*	*(5bps)*
PAT	**734**	**589**	**695**	**24.8**	**5.7**
EPS (Rs)	2.4	1.9	2.3	24.2	5.5
BV (Rs)	94.8	87.2	92.4	8.6	2.5
Deposits	2,61,687	2,05,671	2,50,324	27.2	4.5
Advances	2,20,688	1,73,950	2,12,434	26.9	3.9

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Loan and Business Growth

- The management stated that given the current market scenario, NBFCs are now shifting towards conserving liquidity and are limiting disbursements of new loans. As a result, competition is easing up a bit and pricing power may return in 1-2 quarters.
- The management stated that the balance transfer towards end of September was tapering off. The DSAs informed that several NBFCs were not accepting their proposals. The management will have to watch the entire 3rd quarter on this front.
- The management stated that GST and demonetization events have earlier had near term impact and created set backs on DBL's branch performances. (This has an implication on the achievement of targets announced earlier.) The management stated that they do not yet have approval from the board to revise their C/I and ROA guidance.
- The management stated that they are not actively looking out for portfolio purchases from NBFCs. However, DBL follows a retail small ticket strategy in this regard and if any portfolio meets their ROE hurdle, then the bank will certainly consider it.
- Currently corporate banking segment has a share of 15% of total loan portfolio. Management stated that they do not want the share to grow beyond 15-17% of the total loan book. They do not plan to grow this segment faster than 15-20% on an ongoing basis.
- The management stated that 85-90% of clients both on liability and asset side are self-employed. 20% of loan borrowers are retail or wholesale traders.
- Average ticket size per mortgage / SME loan is Rs3-5mn with very few loans greater than Rs30mn.
- To grant credit on their corporate banking book, the management expects a yield of 10-11%. After taking into account other ancillary services such as current accounts and other transactions, the borrower should meet the 14% ROE criteria for credit approval.
- The management stated that GST, as such, is not an issue for their SME portfolio and, in fact, the data has become more reliable. There have been enhancement requests in the SME segment in CC/OD product. However, they are wary of SME clients who claim they will grow rapidly. They do not expose themselves to ticket size greater than Rs30mn.
- The management is aiming to double the total loan book in 3-4 years.
- Management stated that there will be a stepping up on personal loans which have the potential to become 3-4% of the total loan book in the next 3-4 years.
- Management stated that they are not capping their CV book to an upper limit. 70-80% of the CV finance loans granted are PSL compliant. As long as the bank makes good return, they are happy to add to this business. Generally, the target is self employed people and ticket sizes are not large. DBL is able to collect repayments effectively since customers can be revived.

Asset Quality

- AIB segment comprises of KCC and tractors, among other sub-segments. Tractors have a 'yo-yo' type of NPA trend. The management is not really concerned about NPA in AIB. In all, there are 140 odd branches in AIB segment and this segment aids PSL fulfilment.
- LAP segment undergoes deeper filters by DBL when it comes to issuing credit. Management stated that if LAP customers ask for more money, then DBL won't issue more if they don't see additional cash flows. For ticket sizes above Rs30mn, checks are even more intense.
- The management stated that ticket sizes are a key consideration while issuing credit and pricing that issue. DBL conducts internal segment analysis and calculates lifetime loss rate. A lot of factors play role in deciding the pricing of an issue.
- Regarding the construction finance book, management stated that investors have vacated the real estate scene, which is an issue, but they are not seeing any untoward behaviour on this portfolio. Due to RERA, in fact, it is difficult for developers to divert funds now. Average ticket size is Rs50-150mn. This book will aid DBL in securing current accounts of the customers.

Margin

- COF rose from 6.58% to 6.59% on a QoQ basis. The management stated that the COF increased sharply towards the end of September but has improved in the first 2 weeks of October. Given the current market conditions, COF is expected to inch up for the next 2 quarters.
- The management stated that they hiked MCLR by 22bps in the second week of October. Consequently, management guided for NIM to hover between 375-385bps over the next 2 quarters.
- Yield on investments have gone up in the market. On DBL's SLR portfolio, they were sitting on liquidity earlier and now their treasury department has taken the opportunity to improve and look for better yields. PTC transactions are also in the mix.
- The management stated that the YOA was a much bigger issue in 1QFY19. Now, after the NBFC scare, situation has improved and negotiations are happening easier relative to 1st quarter.
- DBL's loan to CV and tractor segments are based on fixed rate.
- DBL engages in interbank deposits and has established relationships mainly with small cooperative banks. These deposits are usually of 1 year or above maturity. The cost of these deposits is not necessarily higher than a 1-year retail TD and could, in some cases, even be lower. DBL helps these cooperative banks with services related to trade, remittances and ATM, thereby building a relationship with them.
- The management stated that they weren't satisfied with their CA growth but are with their SA growth. Once the branches stabilise, the management is aiming for CASA share to reach 27-28%.

Opex

- This quarter witnessed a decline in other opex by 6.34% on a QoQ basis. Management stated that slower branch expansion is key contributor in this regard. DBL currently has a task force which keeps a check on containing operating costs. Furthermore, an accounting change in the useful life of fixed asset leading to reduction in depreciation by Rs45.7mn has alo contributed to this decline in other opex.
- The management stated that inability to carry out e-KYC based on Aadhaar is not a major issue for DBL. There are other important steps in the credit issuance process such as valuation, legal processes that consume greater time, so, KYC time increase doesn't matter much.

Capital

- RWA witnessed lower growth this quarter. The management is working on a deep dive looking at utilisation of capital. DBL has exited from some corporate loans and have replaced them with lower risk weighted retail / mortgage loans. They have put a series of meticulous checks in place for disbursement of loans, especially above 30mn.
- The management stated that a lot of their loans are under regulatory retail category with a lower risk weight and, hence, most of them are capital efficient. For example, loans below Rs3.5mn or below 75% LTV ratio.
- The management stated that due to their superior analytics, they have been able to focus capital consumption at granular levels.

Fee and Other Income

- The management stated that they are usually in excess of the PSL requirement. There is a separate PSL team, which coordinates with treasury to generate PSLC fee income.

Exhibit 1: Key metrics

	2QFY19	2QFY18	1QFY19	YoY (%)	QoQ (%)
Loan book break-up (Rsmn)					
Corporate banking	33,103	29,572	36,114	11.9	(8.3)
AIB	41,931	29,572	38,238	41.8	9.7
CV loans	15,448	8,698	12,746	77.6	21.2
Construction finance	6,621	5,219	6,373	26.9	3.9
Gold loans	4,414	3,479	4,249	26.9	3.9
Others	4,414	3,479	4,249	26.9	3.9
Mortgage loans	88,275	73,059	84,974	20.8	3.9
SME and MSME loans	26,483	20,874	25,492	26.9	3.9
Net loans	2,20,688	1,73,950	2,12,434	26.9	3.9
Other metrics (%)					
Gross NPAs	*1.84*	*1.8*	*1.86*	*4bps*	*(2bps)*
Net NPAs	*0.7*	*0.9*	*0.72*	*(20bps)*	*(2bps)*
Provision coverage ratio	*76.82*	*71.96*	*76.09*	*486bps*	*73bps*
Yield on advances	*11.07*	*11.44*	*11.21*	*(37bps)*	*(14bps)*
Cost of funds	*6.59*	*6.49*	*6.58*	*10bps*	*1bps*
RoA	*0.92*	*0.94*	*0.90*	*(2bps)*	*2bps*
RoE	*11.13*	*8.84*	*10.75*	*229bps*	*38bps*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	7,971	9,954	12,050	15,420	20,005
Pre-provision profit	4,176	5,250	6,468	9,149	13,302
PAT	1,991	2,453	3,183	4,707	7,224
EPS (Rs)	7.0	8.0	10.3	13.9	21.3
BV (Rs)	77.3	91.1	100.3	127.9	148.0
P/E (x)	22.9	20.1	15.5	11.5	7.5
P/BV (x)	2.1	1.8	1.6	1.3	1.1
Gross NPAs (%)	*1.6*	*1.8*	*1.7*	*1.5*	*1.2*
Net NPAs (%)	*0.8*	*0.7*	*0.8*	*0.7*	*0.5*
RoA (%)	*0.9*	*0.9*	*0.9*	*1.1*	*1.4*
RoE (%)	*10.0*	*9.8*	*10.8*	*12.7*	*15.5*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Actual performance versus our estimates

(Rsmn)	2QFY19	2QFY18	1QFY19	YoY (%)	QoQ (%)	2QFY19E	Devi. (%)
Net interest income	2,818	2,481	2,730	*13.6*	*3.2*	2,730	*3.2*
Pre-provision profit	1,461	1,244	1,414	*17.5*	*3.3*	1,414	*3.3*
PAT	734	589	695	*24.8*	*5.7*	695	*5.7*

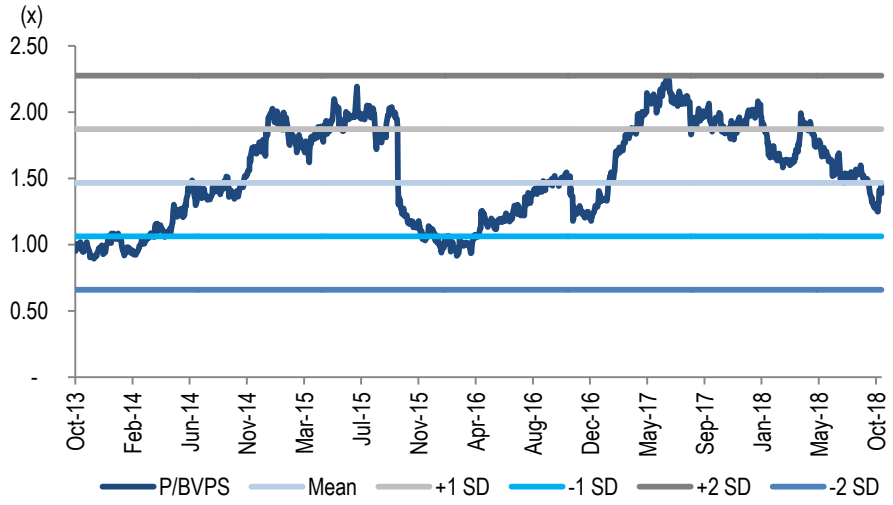
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Change in our estimates

	Revised estimate			Earlier estimate			% Revision		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	12,050	15,420	20,005	12,006	15,264	*19,883*	*0.4*	*1.0*	*0.6*
NIM (%)	*3.9*	*4.0*	*4.2*	*3.9*	*4.1*	*4.2*	*-*	***(1bps)***	***(4bps)***
Operating profit (Rsmn)	6,468	9,149	13,302	6,432	9,015	*13,213*	*0.6*	*1.5*	*0.7*
Profit after tax (Rsmn)	3,183	4,707	7,224	3,168	4,641	*7,190*	*0.5*	*1.4*	*0.5*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 6: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	20,761	24,130	30,417	37,935	47,945
Interest expenses	12,791	14,176	18,367	22,514	27,940
Net interest income	**7,971**	**9,954**	**12,050**	**15,420**	**20,005**
Fee income	1,651	2,192	2,873	3,619	4,774
Other income	838	911	917	1,304	1,583
Net revenues	10,459	13,057	15,839	20,343	26,362
Operating expenses	6,283	7,807	9,371	11,194	13,061
-Employee expenses	3,080	3,812	4,315	4,824	4,981
-Other expenses	3,203	3,995	5,056	6,370	8,080
Operating profit	**4,176**	**5,250**	**6,468**	**9,149**	**13,302**
Provisions	1,115	1,388	1,646	2,018	2,356
-Loan loss provision	944	1,169	1,634	2,004	2,338
-Investment depreciation	(1)	61	12	14	17
-Other provisions	172	158	-	-	-
PBT	3,061	3,862	4,822	7,131	10,946
Tax	1,070	1,408	1,640	2,425	3,722
PAT	**1,991**	**2,453**	**3,183**	**4,707**	**7,224**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity capital	2,854	3,081	3,081	3,389	3,389
Reserves & surplus	19,195	24,997	27,809	39,944	46,760
Shareholders' funds	**22,049**	**28,078**	**30,890**	**43,333**	**50,149**
Deposits	**1,92,892**	**2,40,069**	**2,92,944**	**3,59,567**	**4,48,355**
Borrowings	12,758	19,267	23,747	27,066	42,413
Other liabilities	12,765	14,807	20,335	26,374	32,753
Total liabilities	**2,40,464**	**3,02,221**	**3,67,916**	**4,56,340**	**5,73,670**
Cash/equivalent	11,925	23,720	19,218	24,215	30,874
Advances	1,58,176	2,03,367	2,56,242	3,22,865	4,11,653
Investments	58,179	62,190	78,857	94,955	1,16,073
Fixed Assets	4,886	4,940	5,434	5,978	6,575
Other assets	7,298	8,004	8,165	8,328	8,494
Total assets	**2,40,464**	**3,02,221**	**3,67,916**	**4,56,340**	**5,73,670**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Key ratios

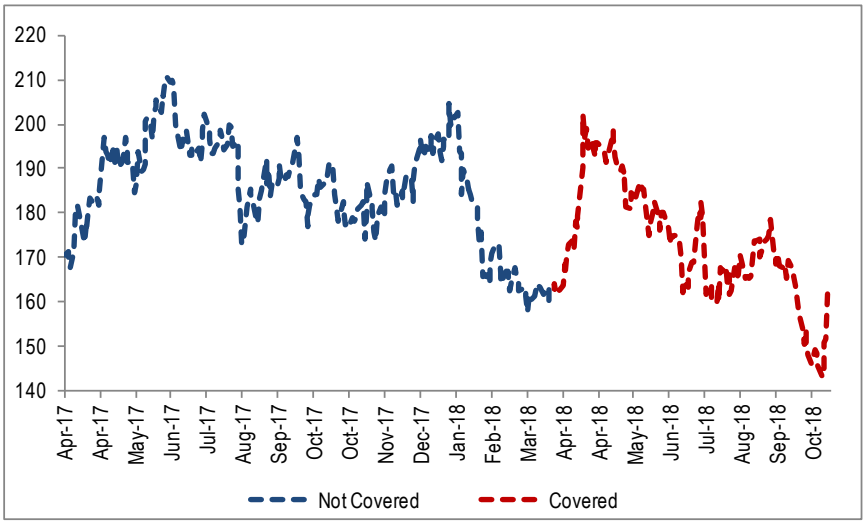
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	28.7	24.9	21.1	28.0	29.7
Pre-provision profit growth	19.6	25.7	23.2	41.4	45.4
PAT growth	2.3	23.2	29.7	47.9	53.5
Business (%)					
Deposit growth	29.2	24.5	22.0	22.7	24.7
Advance growth	22.4	28.6	26.0	26.0	27.5
Business growth	26.1	26.3	23.8	24.3	26.0
CD	82.0	84.7	87.5	89.8	91.8
CASA	24.3	24.3	26.2	28.2	28.9
Operating efficiency (%)					
Cost-to-income	60.1	59.8	59.2	55.0	49.5
Cost-to-assets	2.9	2.9	2.8	2.7	2.5
Productivity (Rsmn)					
Business per branch	1,340.0	1,403.3	1,659.2	1,972.3	2,407.3
Business per employee	71.2	76.6	92.2	112.7	137.6
Profit per branch	7.6	7.8	9.6	13.6	20.2
Profit per employee	0.4	0.4	0.5	0.8	1.2
Spreads (%)					
Yield on advances	11.5	10.7	10.6	10.7	10.8
Yield on investments	7.8	7.0	7.5	7.5	7.5
Cost of deposits	6.9	6.0	6.2	6.3	6.2
Yield on assets	10.6	9.7	9.9	10.0	10.0
Cost of funds	7.0	6.1	6.4	6.4	6.4
NIMs	4.1	4.0	3.9	4.0	4.2
Capital adequacy (%)					
Tier I	11.9	12.7	11.1	12.3	11.2
Tier II	1.9	3.8	2.8	2.5	2.2
Total CAR	13.8	16.5	13.9	14.8	13.4
Asset quality (%)					
Gross NPAs	1.6	1.8	1.7	1.5	1.2
Net NPAs	0.8	0.7	0.8	0.7	0.5
Specific provision coverage	50.0	60.1	51.7	52.9	60.5
Slippage	1.8	1.9	1.8	1.5	1.2
Credit-cost	0.5	0.6	0.6	0.6	0.5
Return (%)					
RoE	10.0	9.8	10.8	12.7	15.5
RoA	0.9	0.9	0.9	1.1	1.4
RoRWA	1.3	1.3	1.4	1.6	2.0
Per share (Rs)					
EPS	7.0	8.0	10.3	13.9	21.3
BV	77.3	91.1	100.3	127.9	148.0
ABV	72.8	86.4	93.4	121.3	142.2
Valuation (x)					
P/E	22.9	20.1	15.5	11.5	7.5
P/BV	2.1	1.8	1.6	1.3	1.1
P/ABV	2.2	1.9	1.7	1.3	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	160	196
17 April 2018	Buy	190	223
17 July 2018	Buy	162	205
9 October 2018	Buy	143	200
19 October 2018	Buy	160	207

Rating track graph



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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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