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DCB Bank Ltd.

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DCB Bank post the organisational re-structuring in 2009, has grown at a healthy pace, focussing on growth as well as profitability. DCB Bank emerged as a new generation private sector bank with 134 branches across 15 states and 2 union territories. Considering its healthy loan book growth, superior asset quality, stable NIM and steady branch network expansion, we believe DCB Bank is well poised to continue its growth trajectory.

Investment Rationale

Continue to maintain strong growth momentum

DCB Bank continued to show strong growth trajectory post organisation restructuring by doubling its balance-sheet size from FY11to FY15. We expect DCB Bank to post robust earnings growth of ~17% CAGR over FY15-17E, with return on asset (RoA) of 1.2%, one of the best among small-cap banking peers. With positive economic outlook, we expect the stock to sustain its premium valuations ahead led by stronger business growth, stable asset quality, and greater capital adequacy.

Emphasis on secured lending to strengthen its loan portfolio

DCB Bank continued to maintain healthy liability franchise, with retail deposits comprising 80% of total deposits and savings deposits comprising ~63% of CASA at the end of FY15. The bank's exposure towards secured lending would help it in maintaining superior asset quality. The bank expects to maintain current loan portfolio mix of 43% mortgages, 6% retail, 13% SME, 15% agri & 23% corporate in the long term. Thus, on the back of its strategy of focusing on small-ticket loans and secured loans, we expect DCB Bank to grow its loan book at a CAGR of ~26% in FY15-17E.

Focus on branch expansion and self-employed customer to drive balance sheet growth

Rising competition from large private banks may impede the business growth of the bank. But the bank's efforts in mitigating the risk by focusing on self-employed customer and branch expansion are likely to result in healthy business growth. The bank added 50 branches in last two years taking its total to 154 branches by the end of FY15. The bank further intends to expand its geographical presence by adding 25-30 branches per year, primarily in tier II and tier VI cities across Odisha, Madhya Pradesh, Chhatisgarh and Rajasthan to tap the growing business, which in turn would result in healthy CASA traction. With its strategy of serving self-employed customers and branch expansion, the bank aims to double its balance sheet size in 3.5 years.

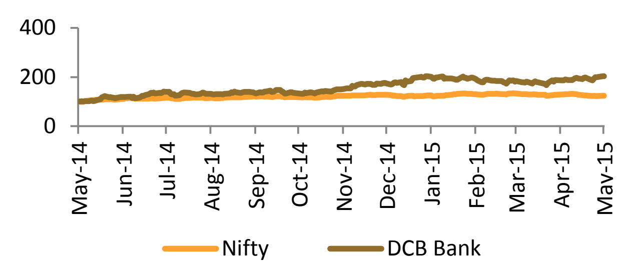
Market Data

Rating	**BUY**
CMP (₹)	126
Target (₹)	**148**
Potential Upside	~18%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	136.9/69.2
Adj. all time High (₹)	170
Decline from 52WH (%)	8.0
Rise from 52WL (%)	82.1
Beta	1.3
Mkt. Cap (₹cr)	3,553.3
Book Value (₹cr)	1,585.4

Fiscal Year Ended

Y/E	FY14A	FY15A	FY16E	FY17E
NII (₹cr)	368.4	508.2	654.6	815.3
PAT (₹cr)	151.4	191.2	219.7	264.3
EPS (₹)	6.0	6.8	7.8	9.4
P/E (x)	20.8	18.6	16.2	13.4
P/BV (x)	2.7	2.2	1.9	1.6
ROA (%)	1.3	1.3	1.2	1.2
ROE (%)	14.1	14.0	12.7	12.9

One year Price Chart



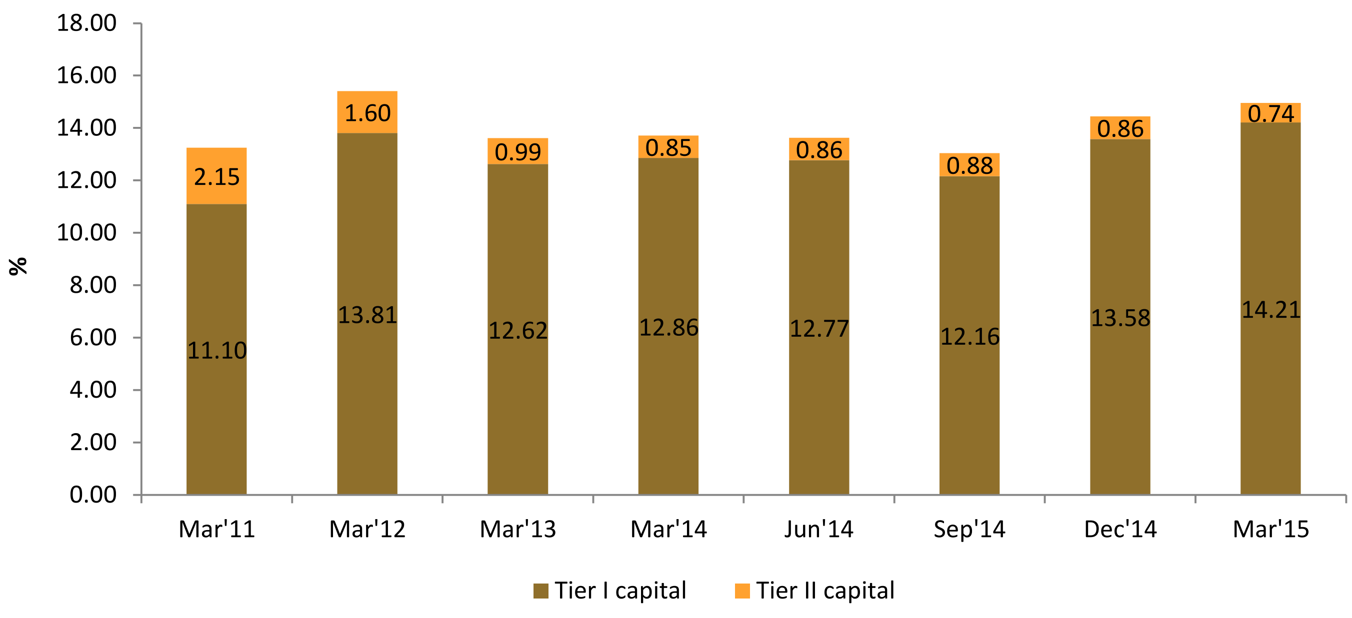
Shareholding Pattern	Mar 15	Dec14	Diff.
Promoters	16.4	16.4	0.0
FII	14.7	15.5	(0.8)
DII	23.5	24.3	(0.8)
Others	45.5	43.8	1.7

DCB Bank; the country's new emerging private sector lender

Post amalgamation of Ismailia and Masalawalla co-operative banks, Development Co-operative Bank Ltd. was founded in 1930. Later in 1995, the bank gets a private banking license and becomes a scheduled commercial bank named as Development Credit Bank (DCB) Bank Ltd. DCB Bank caters to diverse business segments includes; retail, micro-SMEs, SMEs, mid-corporate, agriculture, commodities, among others. DCB Bank emerged as a new generation private sector bank with 134 branches across 15 states and 2 union territories. Till FY09, DCB Bank was saddled with significantly high non-performing loans (GNPA of 8.4%) and low productivity (opex-to-assets of 3.6%). DCB Bank has undergone significant restructuring over the last five years. Post structural transformation, which took place in May in 2009, the bank has achieved an impressive turnaround in operations. The bank's new management focus was laid on realigning organizational structure to bring cost efficiencies and consolidate balance sheet growth. This led to the bank considerably shifting its business focus from unsecured assets to secured assets.

Over FY10-14, DCB Bank's management managed to reduce its unsecured lending exposure and shifted its focus to secured lending across diverse segments, while maintaining a consistently large share of retail deposits (~81%). This strategy has resulted in better recoveries and improved credit quality, expanded risk-adjusted NIMs, and better profitability as well as capital adequacy. Since FY11, the bank has been maintaining strong capital position, with capital adequacy ratio (CAR) of more than 13%. In order to meet Basel III norm, the bank raised funds worth ₹2,50 crore in October, 2014, which in turn has further boosted its CAR to 14.95%, with tier-1 capital of 14.21% at the end of FY15.

Consistently maintaining healthy capital adequacy under Basel III norm



* Capital Adequacy Ratio is under Basel III from September 30, 2013 (Prior period ratios are under Basel II)

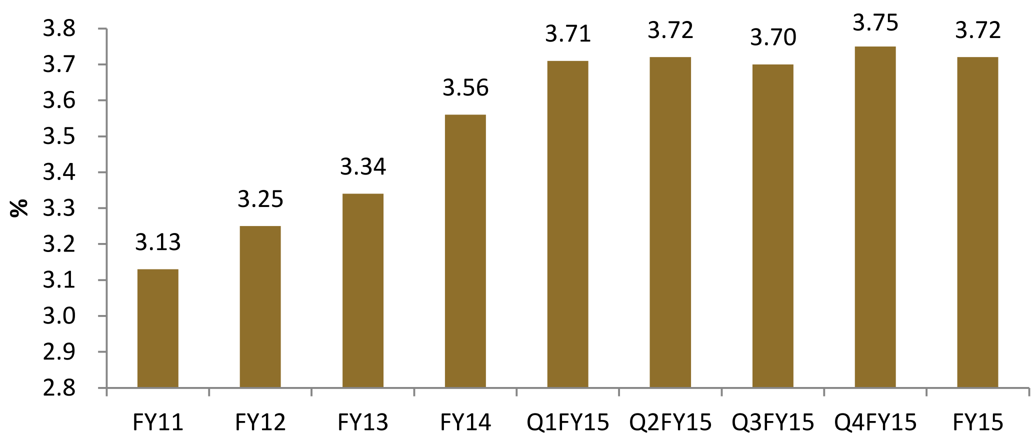
NIM to remain intact in next two years

Improvement in liability profile led to better than expected NIMs performance.

Despite the low share of risky assets and high yielding unsecured loans, NIM of the bank improved substantially from 2.50% in FY09 to 3.72% in FY15 supported by better asset quality performance. In Q4FY15, the bank's NIM's rose 25 bps to 3.75% on the back of high credit-deposits of 83% and the recent capital raise of ₹2.5 billion. However on sequential basis, the bank's NIM declined by 7 bps followed by 11 bps QoQ increase in cost of fund coupled with slight reduction in CASA share during Q4FY15. With rising pressure of increased competitive intensity, we expect NIM to remain stable in the coming years.

Thus, the bank's increasing focus on some high-yield rise in unsecured retail loans such as CV loans, loan against property and initiatives on liability side such as increasing CASA ratio on the back of sustained branch expansion would help it to keep NIMs intact in the long term. Going forward, we believe that the bank is likely to benefit from RBI's move of lowering of interest rate, which in turn would create more demand of credit in the market. Thereby, we believe that the any near term rate cut move by RBI is likely to make loans cheaper, which in turn would lead to higher disbursement of loans resulting in to higher earnings visibility. Further, in a falling interest rate scenario, liabilities would re-price faster and aid margins.

Strong NIM trend



Loan book to grow at a CAGR of ~17% in FY15-17E

Since FY09, the bank has undergone a significant transformation. 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. With impetus on diversification, the bank reduced its focus from unsecured loan such as personal and commercial vehicle (CV) to secured retail loans such as loan against property (LAP) and low-ticket SME loans up to ₹10 crore, agri and inclusive banking and trade-related corporate loans for incremental growth.

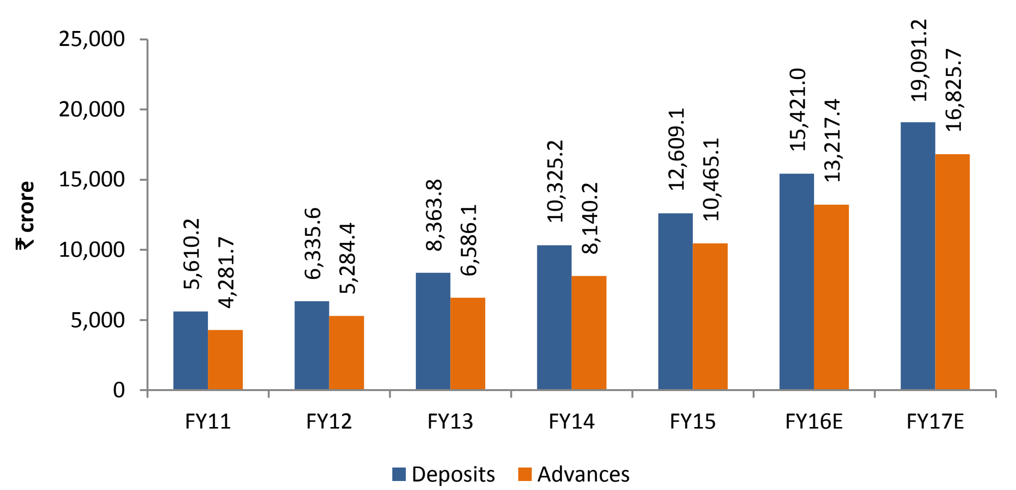
Subsequently, DCB Bank's balance-sheet stability returned, its advances grew at a CAGR of 19.6% over FY11-15 outpaced the banking sector's CAGR growth of 17% during the same period. In FY15.

Post FY11, the bank witnessed more than 2x growth in its credit book from ₹4,281.7 crore in FY11 to ₹10,465.1 crore in FY15.

alone, the bank's advances grew 28.6% YoY compared to the banking sector's growth of 12.6% YoY. With strong impetus on asset growth, the bank launched 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. The advances growth was driven by the mortgages (42.5% YoY) and agri & inclusive banking (39.4% YoY) segments. With enhanced focus on mortgages, the bank has increased its share of mortgage lending from 8% in FY09 to 43% in FY15. Within mortgages, loan against property constitutes ~70% of mortgage portfolio, while remaining 30% of mortgage loan constitutes by home loans. With higher share of mortgages in overall loans, the bank is well placed to gain market share in this segment.

Proportion of mortgage and agri-inclusive banking in total loans rose 416bps and 120bps to 42.6% and 15.4%, respectively in FY15. While corporate, SME and retail contributes ~23%, ~13%, and ~6% of total loan in FY15, respectively. To compete with larger banks and establish itself, the bank is focusing on expanding its reach to tier II and below cities, where its emerge as the top two private sector bank, which in turn would propel advances growth in chosen segments of MSME and agri business. Given its core strategy of growing cautiously, we expect the bank's mortgages, agri and inclusive banking and SME segments will continue to drive its overall loan book growth. **With continued focus on secured loans in the SME, micro-SME, retail-mortgage, and CV segments, we expect the bank's advances to grow at a CAGR of 26.8% over FY15-17E.**

Deposites and advances trend



Sustained investment in network expansion to drive CASA growth

We expect deposits to grow at a CAGR of 23% over FY15-17E. Also, the bank's branch expansion strategy and positive macroeconomic outlook could improve CASA traction.

Since FY09, DCB Bank shifted its focus from wholesale to retail liabilities in order to de-risk its balance sheet. In order to fund growth, the management of the bank reduced its reliance on wholesale borrowings by raising the share of retail liabilities in total liabilities Due to this, the share of retail deposits to total deposits increased from 52% in FY08 to 80% in FY15, providing stable funding sources, which are less volatile in nature subject to interest rate. While, the share of bulk deposits remained at just 18%, lower than most of its larger peers.

Over FY10-14, the bank's deposits growth, which expanded at 21.2% CAGR, surpassed the industry growth of 15.3% CAGR during last five years. However, due to stagnant branch network and increased competition following deregulation of SA rates, the bank witnessed steady decline in overall CASA share from 31% in FY09 to 23.4% in FY15. In order to accelerate CASA growth and maintain healthy momentum in retail term deposits, the bank aims to add ~25 to 30 branches in FY16E from 154 branches in FY15. We expect retail deposits to continue to be maintained at its current proportion of 81% in the total deposit mix. We estimate total deposits will grow at a CAGR of 23% in FY15-17E.

Better risk practices to keep asset quality at healthy level

Improved back-end processes and risk management systems to tackle asset quality issues, yielded results with slippages in SME+MSME lending segment continuously trending down.

On asset quality front, the bank continued to witness improvement with gross non-performing asset (GNPA) and net non-performing asset (NNPA) ratio declining from 8.7% and 3.1% in FY10 to 1.8% and 1.0%, respectively in FY15. On the back of improved risk management and higher proportion of secured loans, the bank succeeded in containing risky credit portfolio, with strong provision coverage ratio (PCR) of 74.7% in FY15, providing further comfort to asset quality. We expect DCB Bank's existing strong asset-liability base followed by better risk management strategies to help the lender to remained focus on collateralized SME and retail loans and thereby provide adequate cushion against probable asset quality risks. Better provisioning policies will also help the bank to maintain its present asset quality standard.

Healthy superior returns to withstand current growth

DCB Bank has been consistently generating superior shareholder returns with return on assets (RoAs) and return on equity (RoE) growing more than 1% and 11%, respectively from last three years. Given improving retail liabilities, high RoAs and well-capitalized position (Tier1 capital at 14%), we expect return ratios to remain strong, which in turn will ensure that the bank will be able to bridge the gap in discount to its peers - South Indian Bank and Karur Vysya Bank. Thus, on the back of structural improvement in earnings (up ~9x in the last five years) and best in class return ratios, we expect the bank's RoE and RoA to remain above 1.0% and 12.0% level, respectively in FY17E.

Impressive turnaround performance

DCB Bank continued its strong operational performance in Q4FY15, with NII increasing 29.6% YoY and other income rising 38.2% YoY, respectively led by strong business growth.

In FY15, DCB Bank has reported a healthy set of numbers, with 26.3% YoY robust growth in net profit at ₹191.2 crore on sturdy net interest income (NII). Strong loan growth and improvement in net interest margin (NIM) triggered 38% YoY improvement in NII at ₹508.2 crore in FY15. Further, non-interest income of the bank grew by 19.5% YoY to ₹165.7 crore in FY15.

In Q4FY15, DCB Bank has reported 61% YoY rise in net profit to ₹63 crore as compared to ₹39.1 crore in the same quarter of the previous financial year, helped by higher NII and a tax write back of ₹9.25 crore. NII of the bank during Q4FY15 increased by 29.7% YoY to ₹129.7 crore from ₹100 crore in Q4FY14 driven by strong credit growth and healthy NIM of 3.75%. While on the other hand, operating expenditure of the bank grew by 29.5% YoY mainly due to aggressive branch expansion and higher staff cost. As a result, the bank's cost to income (C/I) ratio increased to 61.4% as against 59.8% in Q3FY15 and 62.4% in Q4FY15.

With improvement in economic outlook coupled with the bank's prudent business growth strategy, we believe DCB Bank is well-poised to enter the next leg of growth, with an earnings visibility of 17.6% CAGR over FY15-17E.

Balance Sheet (Standalone)

Y/E (₹cr)	FY14A	FY15A	FY16E	FY17E
Paid up capital	250.3	282.0	282.0	282.0
O/s Employees stock options	3.0	3.2	3.2	3.2
Total reserve surplus	900.7	1,303.4	1,589.5	1,937.9
Deposit	10,325.2	12,609.1	15,421.0	19,091.2
Borrowings	860.2	1,163.8	1,465.2	1,775.8
Other liabilities	583.9	770.8	871.0	1,001.7
Total Equity Liabilities	**12,923.1**	**16,132.3**	**19,631.9**	**24,091.8**
Cash & Balanc with RBI	505.1	633.7	646.4	659.3
Money call & sho notice	184.5	85.5	92.3	99.7
Investments	3,634.2	4,470.6	5,141.1	5,916.1
Advances	8,140.2	10,465.1	13,217.4	16,825.7
Fixed assets	238.6	236.7	272.2	304.8
Other assets	220.5	240.8	262.5	286.1
Total Assets	**12,923.1**	**16,132.3**	**19,631.9**	**24,091.8**

Profit & Loss Account (Standalone)

Y/E (₹cr)	FY14A	FY15A	FY16E	FY17E
Interest income	1,128.3	1,422.4	1,678.5	2,064.5
Interest expense	759.9	914.2	1,023.9	1,249.2
Net Interest Income	**368.4**	**508.2**	**654.6**	**815.3**
Non-interest income	138.7	165.7	190.6	217.3
Operating income	507.1	673.9	845.1	1,032.6
Operating expenses	319.1	396.5	475.8	594.7
Profit before provisions	**188.0**	**277.4**	**369.3**	**437.9**
Provisions	36.6	69.4	76.4	85.5
Tax	0	16.8	73.2	88.1
Net Profit	**151.4**	**191.2**	**219.7**	**264.3**

Key Ratios (Standalone)

Y/E	FY14A	FY15A	FY16E	FY17E
Avg. Cost of deposits (%)	18.2	17.7	16.2	16.2
ROA (%)	1.3	1.3	1.2	1.2
ROE (%)	14.1	14.0	12.7	12.9
Interest Expense/ Interest Income (%)	67.3	64.3	61.0	60.5
Investment/Deposit (%)	37.4	35.3	34.3	32.0
Cost-Income ratio (%)	62.9	58.8	56.3	57.6
Credit-deposit ratio (%)	78.8	83.0	85.7	88.1
BVPS (₹)	46.0	56.2	66.4	78.7
P/ BVPS (x)	2.7	2.2	1.9	1.6
EPS (₹)	6.0	6.8	7.8	9.4
P/E (x)	20.8	18.6	16.2	13.4

Valuation and view

DCB Bank has delivered another strong operating performance since last five years, on account of granular credit profile and healthy liability franchise. Given the bank's relentless focus on improving asset management practices and adequate collateral cover, we expect the bank to maintain best asset quality among its peers. With strong balance sheet growth, we expect DCB Bank to grow much faster than its peers. Thus, we believe that better visibility of profitable growth along with stable asset quality & improving return ratios instils further confidence in the stock. Hence considering the improving fundamentals & strong growth prospects, we remain positive on the stock.

We initiate BUY rating on DCB Bank. At a current CMP of ₹126, DCB Bank is currently trading at P/BV of 1.9x for FY16E and 1.6x for FY17E. Considering the bank's strong fundamentals, we recommend 'BUY' with a target price of ₹148, which implies potential upside of ~18% to the CMP from 1 year perspective.

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