KEYNOTE

High Conviction Report

DCB Bank Ltd.

16th Oct 2023

Performance in the Driver's Seat, with Valuation on the Horizon

Incorporated in 1995, DCB Bank Ltd. (DCB) was formed through the merger of Ismailia Co-operative Bank Limited and Masalawala Cooperative Bank. DCB is promoted by the Aga Khan Fund for Economic Development (AKFED), an international development enterprise promoting entrepreneurship and building economically sound companies. Under the leadership of Mr. Murali Natarajan since FY10, the Bank has achieved impressive growth, with a 19% CAGR in its loan book and ~20% CAGR in Net Interest Income (NII). The Bank underwent a strategic transformation, focusing on retail banking and shifting toward small-ticket (< Rs. 30 Mn) size loans and secured loans (constitute over 50% of the loan book, up from 12% in FY10), particularly in Tier II-VI cities. DCB has also enhanced granularity on both the assets and liabilities front by reducing concentration risk. In FY23, the Bank demonstrated robust performance, and we expect that the Bank will sustain its momentum as it aims to double its loan book in the next three to four years. Going forward, we expect a reduction in the cost-to-income ratio and an improvement in asset quality. These factors are poised to drive profit growth and enhance its return ratios. In light of these prospects, we initiate coverage on DCB Bank Ltd. with a BUY rating and a target price of Rs. 250 (1.2x FY26 Adj. Book Value).

Doubling the loan book every three to four years

Since FY11, DCB Bank's loan book had nearly doubled every three years, achieving an impressive 22% CAGR from FY11 to FY20. However, in 2021, the emergence of COVID-19 disrupted the economy, and the Bank encountered challenges due to a market slowdown. In FY22, as the economy normalized, the management again aimed to double its loan book over the next three to four years, with a strategic focus on capacity building and strengthening teams across verticals to support its growth aspirations. Encouragingly, RBI sectoral data has indicated a healthy growth momentum, with robust Month-on-Month (MoM) growth of at least 15% Year-on-Year (YoY) from April to August in FY24. We anticipate the DCB loan book to expand by 20-22%, driven by factors such as increased staffing, branch expansion, expanding co-lending partnerships, and leveraging technology.

Operating leverage to kick in

Over FY11-23, the Bank's loan book and NII have exhibited an impressive 19% and 20% CAGR, respectively. The operating cost over the same period has increased by 16%, while in the past two years, the Bank faced cost escalations attributed to its proactive team expansion, branch network growth, and reduced other income due to regulatory adjustments. Despite these challenges, the Bank's PPOP has consistently ascended, maintaining a steadfast 20% CAGR from FY11 to FY23. We expect improvement in the cost-to-income ratio as management guided lower growth in operating cost compared to income, which will result in operating leverage kicking in, leading to higher earning growth and improving the return ratios for the Bank.

View & Valuation

We initiate coverage on DCB Bank Ltd. with a BUY rating and a target price of Rs. 250 (1.2x FY26 Adj. Book Value). We believe that DCB is set to grow its loan book at 20-22% with a stable NIM of 3.70-3.75%. Improvement in the cost-to-income ratio and provision will lead to the normalization of asset quality. All these factors will lead to profitability growth and enhance its return ratios.

BUY

CMP Rs. 123

TARGET Rs. 250 (+103%)

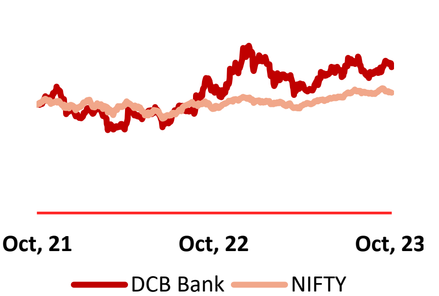
Company Data

Bloomberg Code	DCB IN
MCAP (Rs. Mn)	38,376
O/S Shares (Mn)	312
52w High/Low	141 / 96
Face Value (in Rs.)	10
Liquidity (3M) (Rs. Mn)	183

Shareholding Pattern %

	Jun 23	Mar 23	Dec 22
Promoters	14.8	14.8	14.9
FIIs	12.3	12.3	12.4
DIIs	39.7	39.9	39.4
Non-Institutional	33.2	33.0	33.3

DCB Bank vs. Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY23	FY24E	FY25E
NII	17	19	23
PPOP	8	10	13
Net Profit	5	6	8
Advances	344	419	503
ROE (%)	10.2%	11.2%	13.1%
ROA (%)	0.9%	1.0%	1.1%

Source: Company, Keynote Capitals Ltd.

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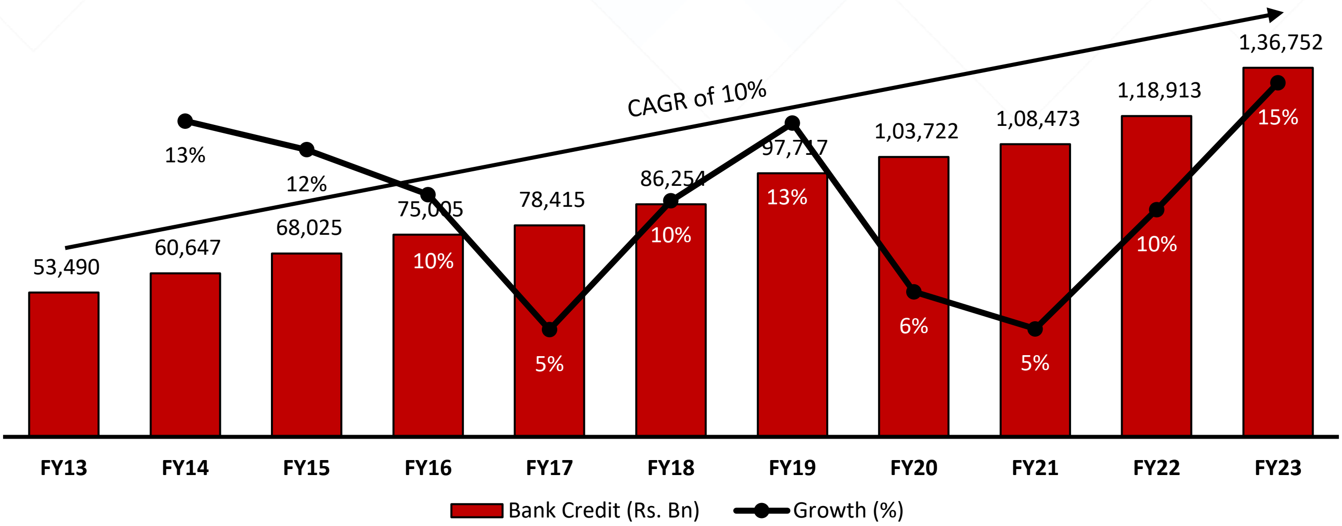
Banking Sector

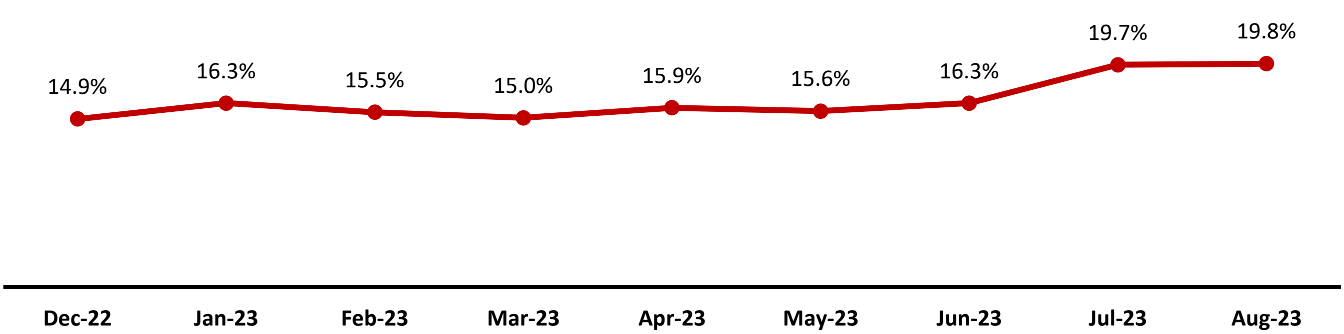
After nine years, the industry is seeing a sign of strength in loan growth, which grew at 15% YoY in FY23. The credit growth numbers continue to grow higher than 15% from April '23 to Aug'23. The outlook for credit growth is expected to remain strong due to the economic expansion, rise in capital expenditure, implementation of the PLI scheme, and continued traction in the Retail and SME segment. The Corporate segment is also reviving due to improved working capital requirements.

Bank credit growth (YoY)



Source: RBI, Keynote Capitals Ltd.

MoM – Growth in credit (YoY)

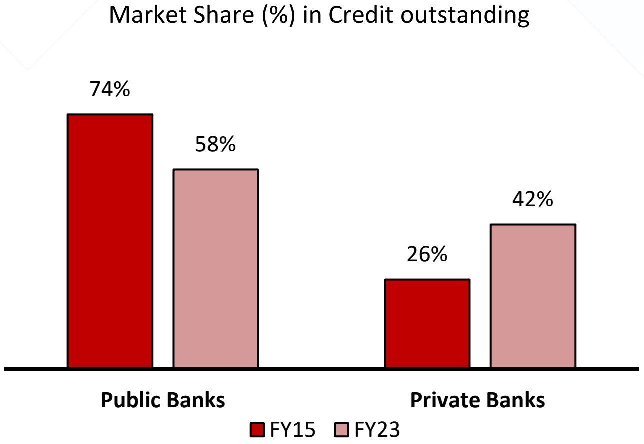


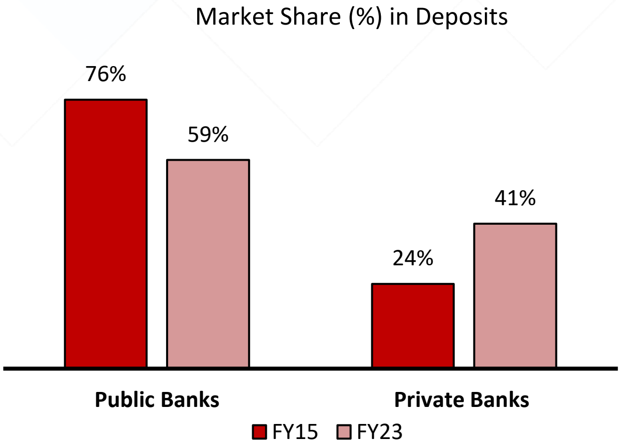
Source: RBI, Keynote Capitals Ltd.

Industry Trends

Private Banks gaining market share

Traditionally, Public Sector Banks (PSUs) have accounted for most of the banking credit outstanding and deposits. However, in the past few years, low profitability, weak capital position, low operational efficiency, and increased stressed loans led to a slowdown in their loan growth. As a result, private banks gained market share, which were relatively well-capitalized and had a higher degree of operational efficiency.





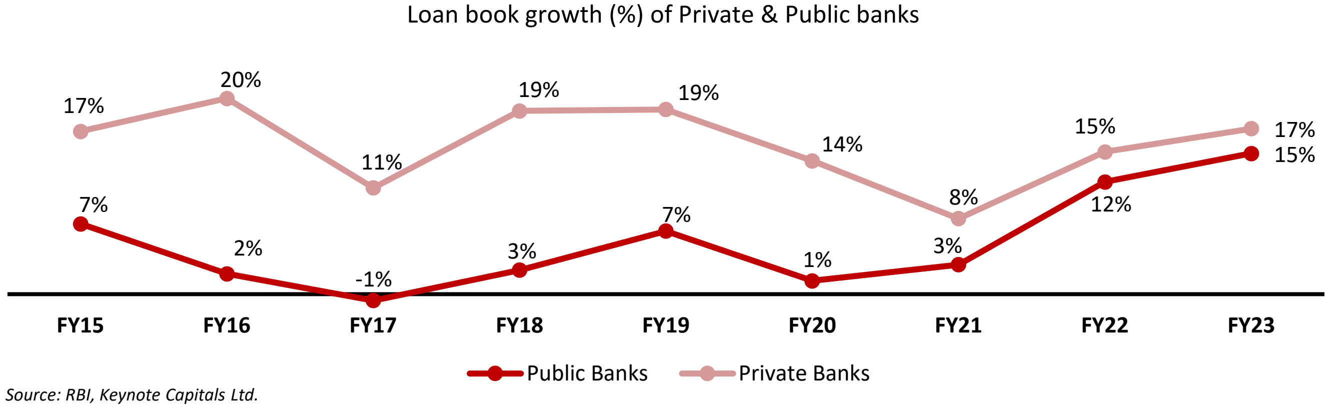
Source: RBI, Keynote Capitals Ltd.

Loan growth to accelerate

In FY21, the Indian economy experienced the steepest contraction due to the impact of COVID-19. However, it rebounded rapidly, leading to a ~10% YoY loan growth in FY22. In FY23, the loan book growth accelerated and expanded by 15% YoY, driven by pent-up demand and the normalization of economic conditions.

Since May 2022, despite several rate hikes, we have witnessed strong credit demand because of higher capex, robust working capital needs, and growth in unsecured pockets. The credit growth is expected to be in the mid-teens, driven by the retail and agriculture segments and supported by a recovery in services and industrial credit. The recovery will be led by private sector banks, which are expected to grow at a higher rate, 15-17%, leading to further market share gains.

In recent years, corporate sector profitability has improved, leading to the companies' de-leveraged balance sheets. This trend is indicative of a fresh phase in the investment cycle.



Source: RBI, Keynote Capitals Ltd.

Asset quality of banks has improved steadily

Post FY18, the Government and the RBI took various measures to restrain the deterioration in asset quality. As we advance, the overall asset quality of banks continues to improve steadily.

Asset Quality									
Particulars	All Banks			Public Banks			Private Banks		
	GNPA	NNPA	PCR	GNPA	NNPA	PCR	GNPA	NNPA	PCR
FY18	11.6%	6.1%	48.1%	15.6%	8.6%	47.1%	4.0%	2.0%	51.0%
FY19	9.3%	3.8%	60.6%	12.6%	5.2%	60.8%	3.7%	1.6%	57.0%
FY20	8.4%	2.9%	66.2%	10.8%	4.0%	64.2%	5.1%	1.4%	72.6%
FY21	7.4%	2.4%	68.9%	9.5%	3.1%	68.4%	4.8%	1.5%	70.0%
FY22	5.9%	1.7%	70.9%	7.6%	2.3%	69.5%	3.7%	1.0%	74.7%
FY23	3.9%	1.0%	74.0%	5.2%	1.3%	73.7%	2.2%	0.6%	74.2%

Note: GNPA – Gross Non-Performing Asset; NNPA – Net Non-Performing Asset; PCR – Provision Coverage Ratio

Source: RBI, Keynote Capitals Ltd.

With better recoveries across the segments, especially in the industrial and agriculture segments, asset quality in the banking sector started improving. GNPAs of all Banks have improved from a high of ~12% in FY18 to ~4% in FY23; PCR has also increased from ~48% to ~74%. While Private Banks are comparatively doing better than the industry, the GNPAs have remained in the range of 2 to 5% between FY18-23, and they have significantly improved the provision coverage ratio, which reduces the risk of asset quality deterioration. We expect the improvement in asset quality across lenders to continue.

The banking sector is well-placed

The Indian banking system is well positioned to support economic growth, with bank credit growing in double-digits after a long hiatus and GNPAs of most of the banks declining to their lowest level in the last six years. A new leg of the investment cycle led by improving trends in capacity utilization and rapid expansion of credit aided by new loan accounts in the industrial and service sector will drive growth opportunities.

The Reserve Bank of India's (RBI) stress test scenario shows that asset quality deterioration will remain within acceptable levels, even lower than in the previous year's stress case. This is encouraging, as it suggests that the banking system is resilient and well-capitalized to support economic growth.

With lower asset quality concerns, the focus will shift to credit growth trends, deposit accretion, and the extent of NIM compression. Indian banks' balance sheets are now much more resilient than they were in the past due to stronger capital buffers, credit quality, liquidity, and stricter regulatory frameworks. The operating environment for Indian banks is likely to remain healthy in FY24, which could lead to a stable ROA despite some moderation in credit growth and margin compression.

Further, multiple MFs and AMCs are taking RBI approval to increase their stake in various banks. Recently, HDFC AMC has taken approval to raise a stake up to 9.5% in DCB Bank, Equitas Small Finance Bank, Federal Bank, Karur Vysya Bank, and City Union Bank. Additionally, Tata MF and DSP MF have taken approval to raise a stake in DCB Bank.

About DCB Bank Ltd.

Incorporated in 1995, DCB Bank Ltd. (DCB) was formed through the merger of Ismailia Co-operative Bank Limited and Masalawala Cooperative Bank. DCB is promoted by the Aga Khan Fund for Economic Development (AKFED), an international development enterprise promoting entrepreneurship and building economically sound companies.

DCB is a mid-size private sector bank offering a wide range of products and services to retail, corporate, Small and Medium Enterprises (SME), Micro Small and Medium Enterprises (MSME) and Agriculture & Inclusive Banking (AIB). Over time, it has created a niche in mortgage financing (~44% of total advances in FY23) with emphasis on small-ticket loans (ticket size < Rs. 30 Mn) to self-employed in Tier II-VI cities. The portfolio is well diversified, with greater reliance on secured lending (~85% of loans are secured in FY23).

Murali Natarajan – The man behind DCB Bank

During 2008-09, DCB was facing several operational issues led by frequent management changes. The Bank was reporting losses led by higher slippage in the corporate sector, resulting in low NIM and higher credit costs. DCB expanded aggressively in risky products, and the share of unsecured loans has increased, leading to a deterioration of asset quality.

During that time, the Bank was scouting for a stable and experienced leader who could lead the Bank to new heights. In May 2009, the Bank appointed Mr Murali Natarajan as the new MD and CEO. While announcing the appointment, the Chairman of DCB, Mr Nasser Munjee, said, "*I am really happy and proud that we have in Murali a personality who has every capacity to lead the bank over the next few years and these are years that are not going to be easy. They are going to be tough and it needs strong hands at the wheel. We have found such a person*."

With 24 years of banking experience in India and overseas and prior employment with Standard Chartered Bank, Citi Bank and American Express, Mr. Murali Natrajan has accepted the challenge to transform the Bank.

Steps initiated by the management to turn around the business

- ❑ Substantial reduction in unsecured personal loans, CV and CE portfolio.
- ❑ De-risking of corporate banking portfolio.
- ❑ Focus on low-cost deposit growth and reduction of bulk deposits.
- ❑ Grow retail, MSME, mid-corporate, and agri / microfinance with a "customer-centric approach." Concentrate on secured lending and diversified portfolios.
- ❑ Improve cost-to-income ratio.
- ❑ Improve ROE numbers.
- ❑ Stabilization of NPAs through intensive collections and recovery efforts.
- ❑ Step up fee income – Bancassurance, MF distribution, trade, FX and cash management.

Performance highlight

Under the leadership of Mr. Natrajan since FY10, the Bank reinvented its business model with greater emphasis on retail banking. The focus shifted towards small ticket (< Rs. 30 Mn) size loans and secured products (mortgage) to SMEs and mid-corporate in Tier II-VI cities, emphasising farm and priority segments lending. The Bank chose to create a niche in the self-employed segment with relatively limited competition, enabling it to improve its NIMs significantly.

The loan book re-aligned in favour of mortgages

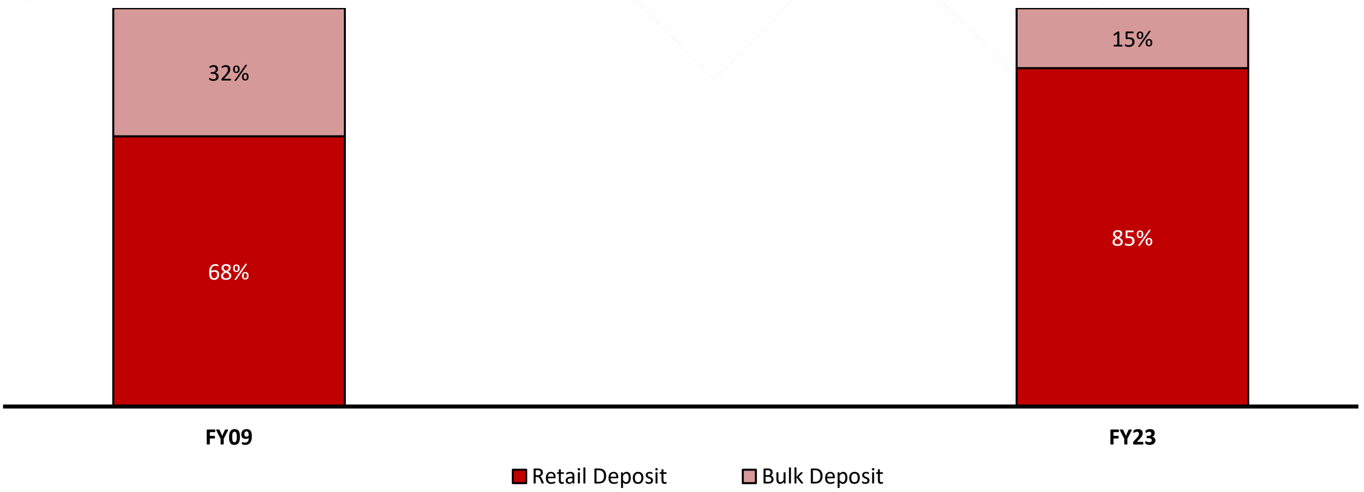
Source: Company, Keynote Capitals Ltd.

Focus on secured portfolio

Source: Company, Keynote Capitals Ltd.

DCB's loan book was highly skewed towards unsecured products and a corporate segment contributing 64% in FY08. This allocation was considered volatile, and it posed challenges for the Bank. In the Q3FY10 concall, the management commented, *"If I look forward what you would see is over the month the Personal Loan, Commercial Vehicle, Construction Equipments will keep going down but will be replaced by Retail Home Loans which is secured, micro-SME, SME which is secured, corporate, mid-corporate which we secured so those are the kind of loans that would replace these loans."* As part of the conscious effort to restructure its business model, DCB started reducing its unsecured portfolio and focusing on secured lending.

The share of retail deposits increased



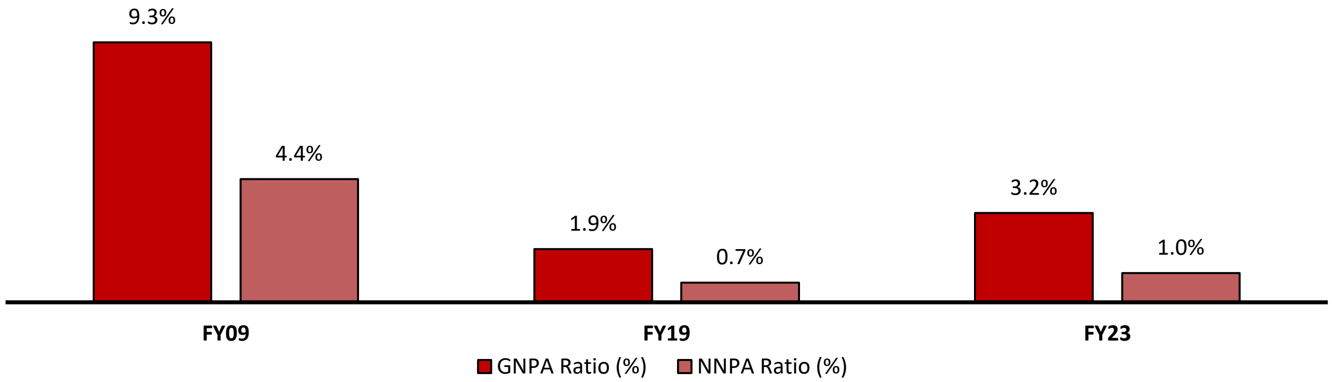
Source: Company, Keynote Capitals Ltd.

Focus on collection and recovery resulted in improvement in asset quality

During FY09-10, there was a decline in asset quality due to defaults on unsecured and corporate loans. This was caused by poor collection and monitoring processes, which led to high GNPA and NNPA ratios. However, post-2009, under new management and a revised strategy that emphasized a shift towards secured lending, de-risking of corporate portfolio, improved collection practices, and a focus on granular growth, DCB managed to enhance its GNPA ratios significantly. GNPAs decreased from 9.3% in FY09 to 1.9% in FY19, with NNPAs declining from 4.4% in FY09 to 0.7% in FY19.

In FY20, due to COVID-19, the asset quality had deteriorated. Going forward, we expect the GNPA to improve from 3.2% in FY23 to fall below 2%.

Improvement in asset quality

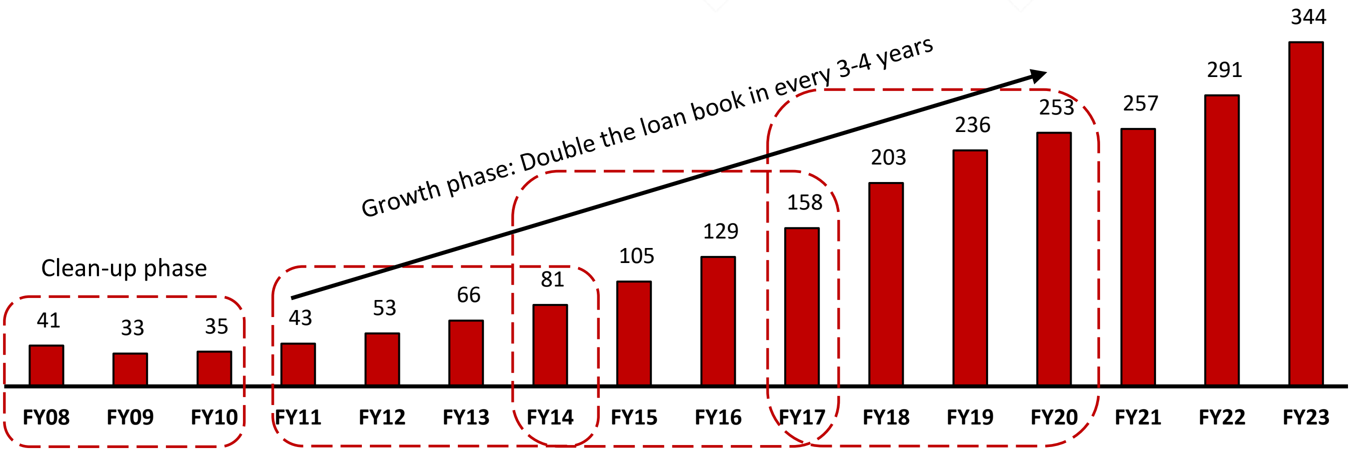


Source: Company, Keynote Capitals Ltd.

Loan Book

DCB's credit growth took a hit in FY09-10 due to the clean-up taking place by the new management. The Bank de-focused on unsecured and corporate lending, even at the cost of de-growing its loan book. Once the portfolio stabilized, the Bank loan book had nearly doubled every three years since FY11. DCB Bank's loan book clocked a 22% CAGR during FY11-20. In 2021, COVID-19 impacted the economy, and the Bank faced headwinds due to a market slowdown. From FY20-22, DCB had slowed down its loan book pace as the self-employed segment, a focused area for the Bank, had been affected the most. In FY22, as the economy normalized, the management aims to double its loan book over the next three to four years.

Loan Book (Rs. Bn)

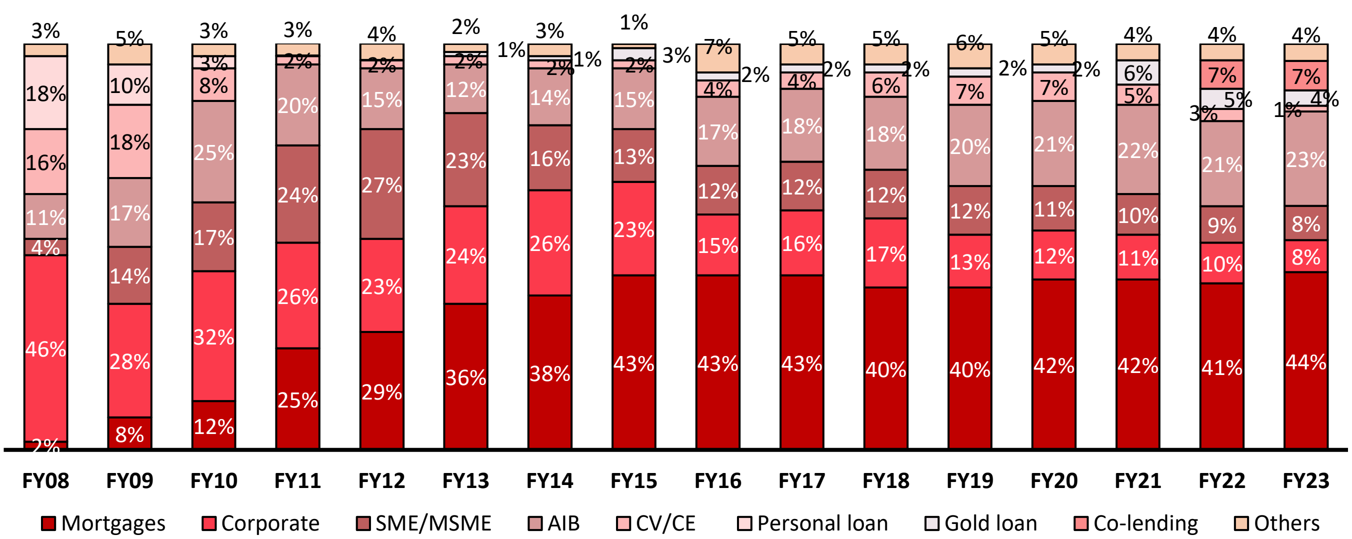


Source: Company, Keynote Capitals Ltd.

Loan Book Mix (%)

The Bank loan book was highly skewed towards unsecured and corporate segments before 2009. Under the new management, the Bank had planned to exit personal loans, commercial vehicles, and construction equipment. The Bank replaced the loan with a secured product like a mortgage for self-employed in the SMEs and MSMEs segment, emphasising Agri and Inclusive Banking (AIB) and priority segments lending.

Loan book mix (%)



Source: Company, Keynote Capitals Ltd.

Segment-wise break-up of loan mix

Key segment	Key products	Customer profile	10-year CAGR (FY13-23)	5-year CAGR (FY18-23)
Mortgage	▪ LAP – accounts for 60-65% (Average LTV – 37%) ▪ Home loan – accounts for 30-35% (Average LTV – 49%)	Self-employed people largely non-salaried.	20%	13%
SME/MSME	Working capital, CC/OD and term loan	▪ SME businesses focus on customers with an annual turnover range of Rs. 100-1,000 Mn. ▪ MSME business focuses on customers with an annual turnover of Rs. <100 Mn. ▪ SME/ MSME target self-employed people in Tier II-VI cities	7%	3%
Corporate	Working capital, term loan, and import & export financing.	Mainly caters to mid-sized companies with an annual turnover range of Rs. 1,000-7,500 Mn.	6%	-5%
AIB	Loans for agricultural farm equipment, term loans to microfinance institutions, mortgage loans for the purpose of home construction, purchase, repairs, business, marriage, education etc.	Mainly caters to agriculture, microfinance and rural customers that are suited for the unbanked areas in rural and semi-urban areas. This segment completes the priority sector lending target for the Bank.	26%	17%
Gold loan	NA		35%	26%
Co-lending	The Bank's intention to partner with NBFCs that offer products which the Bank does not serve.	-	-	-

Source: Company, Keynote Capitals Ltd.

Mortgage loans – continue to drive the overall loan growth

Mortgage is a prime lending product for the Bank and contributed more than 50% (including AIB loan book) of the Bank's loan book in FY23. The Bank offers home and business loans to self-employed and salaried segments at all branches. Over the years, it has created a niche in meeting the credit requirement of self-employed people through mortgages in Tier II-VI locations.

The Bank offers these loans for property purchase, home improvement, home repairs, business requirements (purchase of plant and machinery, purchase of stocks, purchase of shops, working capital) and personal expenses such as education, marriage or medical.

The Bank follows a stringent loan sanctioning process, which includes a) assessing the household income vs. individual income, as many in the rural and semi-urban areas are deriving incomes from the unorganized sectors. Thus, it isn't easy to get proof of their actual capacity to repay, b) personal discussion with the customer about the purpose of the loan and c) all back-office work like document verification, site visits, etc., done by DCB employees for loans sourced through aggregators.

Pre-COVID, the mortgage loan book was growing at a CAGR of 43% from FY09-19. During COVID, the mortgage segment's growth had slowed down and grew at a CAGR of 6% from FY20-22. In FY23, the mortgage business bounced back strongly and increased by 26% YoY. The Bank continued to remain cautious and maintained its focus on small ticket-secured lending.

The Bank is increasing its distribution in the mortgage business by adding frontline headcount and expanding its geographic presence. As a result, the strong growth of 27% YoY in the mortgage segment has continued in Q1FY24. With a strong position in mortgage financing, robust risk management practices, and deeper sourcing capability, the segment will remain a strong growth driver for DCB.

SME/MSME loan segment – continue to remain a focused segment with a small ticket size of secured exposure

The Bank focused on the untapped self-employed SME/MSME segment. Over the years, this segment had to make adjustments to the business models from higher ticket SME loans (Rs. 30-60 Mn) to lower ticket size (Rs. 3-4 Mn) due to increasing stress in the SME segment owning to sluggish economy growth led by demonetisation, GST, and Covid. Hence, the SME/MSME segment contribution declined to 8% in FY23 from 27% in FY12.

Given the inherent risk associated with this segment, the Bank aims to have a large portfolio of small ticket-secured exposure (increased collateral to 100% vs 65-70% earlier) by offering custom-made solutions to meet the credit demand of this segment. The Bank is continuously adding people to grab the opportunity in this segment.

Over the past 1.5 to 2 years, the Bank has actively engaged in the Trade Receivables Discounting Systems (TReDS). TReDS is a platform where large and medium-sized enterprises post their invoices for materials supplied to SMEs. The Bank promptly extends loans to these SMEs, subject to specific fees and interest charges, with a repayment period of 90 to 120 days. DCB used this product as a short-term measure to soak up the excess liquidity that the Bank carry.

Corporate loan book – emphasis is on building a secured loan portfolio with a focus on granularity

DCB has strategically decided to reduce dependence on corporate lending. Consequently, it declined the corporate share in the total loan book from 28% in FY09 to 8% in FY23.

The Bank's intention is to have a limited exposure in corporate segment. The Bank has been successful in staying away from problematic accounts and staying away from riskier sectors.

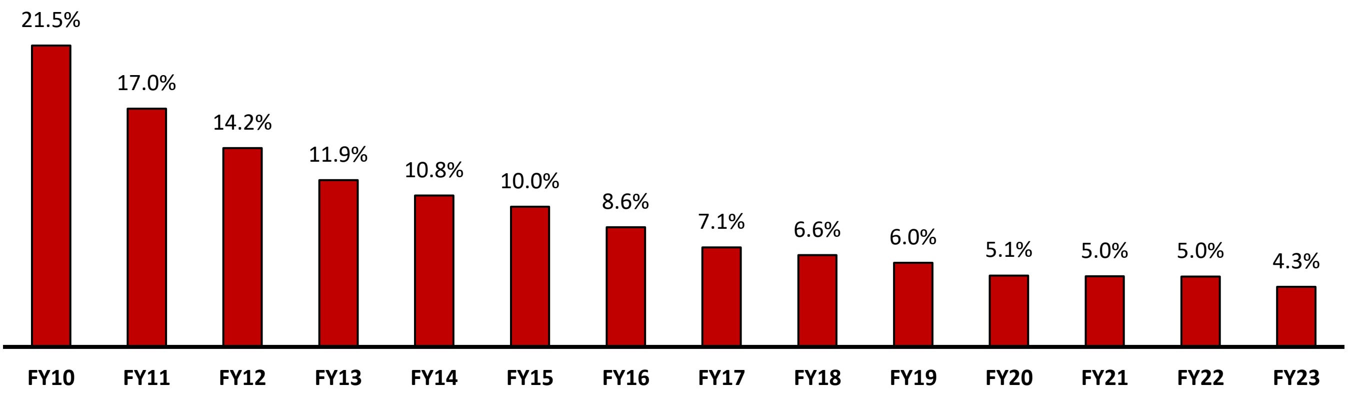
DCB has identified a favourable niche market in the corporate and mid-corporate sectors, where it operates through regional offices in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Mumbai.

The Bank has transitioned from a self-originating approach to a relationship-based corporate banking model, strengthening existing relationships and acquiring new clients. Additionally, DCB has made consistent efforts to granularize the overall loan book, which can be visible from the top 20 borrowers' exposure reduced to 4.3% in FY23 from 21.5% in FY10.

The Bank's emphasis is on building a secured loan portfolio and plans to capitalize on cross-selling opportunities in this segment, which remain largely untapped. The Bank has added over 100 new-to-bank customers in the last two years.

DCB has a strong underwriting team and credit systems to address the inherent risks in corporate banking exposure. Regular review of the existing corporate exposure has enabled DCB to initiate timely action in case of any emerging risks. As a result of the early warning systems in place and timely management of risky exposures, asset quality in corporate banking has remained stable.

Focus on granularity - exposure of top 20 borrowers declined to 4.3% in FY23 from 21.5% in FY10

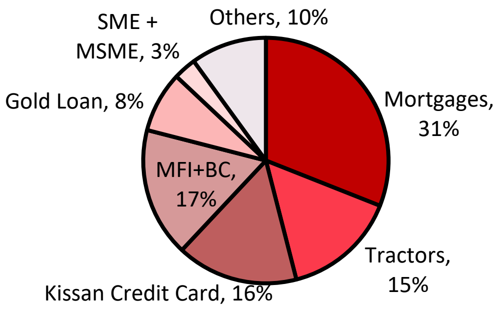


Source: Company, Keynote Capitals Ltd.

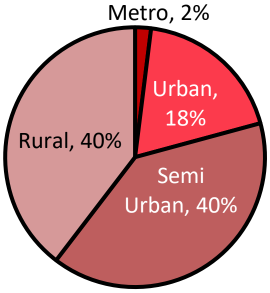
AIB segment

The Bank has formed a separate business segment to meet the Priority Sector Lending (PSL) targets. The Bank had ~45% of the branches dedicated to this segment, i.e., 194 branches in rural and semi-urban areas of Tier II-VI locations in FY23. The segment reported a robust growth of 26%/17% CAGR over the last 10/5 years.

AIB loan mix (%) FY23



AIB Region Wise Branches (%) – 80% of the branches are in rural and semi-urban



Source: Company, Keynote Capitals Ltd.

Gold loan segment – to drive loan growth with negligible delinquencies

The Bank initiated its foray into this segment during FY13 in response to customer demand for gold loans, which offered lower interest costs than NBFCs. This segment was introduced to diversify the Bank's retail customer base, with gold loan offerings available across all Bank branches.

Over the years, the Bank has focused on improving customer experience and service by continuously investing in process improvements by implementing an in-house valuation system and developing a digital platform for paperless gold loan transactions. The automation of verification and validation processes has led to quicker turnaround times and an improved customer experience.

The gold loan segment grew at a strong CAGR of 35%/26% for the last 10/5 years. Due to a change in regulation by RBI in Nov’21 for recognition of NPA from 90 days to any particular day of the previous 90 days, the GNPA deteriorated from 1.4% in FY20 to 8.9% in FY22. While the Bank remained optimistic in this segment due to its 100% secured nature and small loan ticket size of Rs. 0.2-0.4 Mn. The customers are not disciplined in these segments, and the Bank is spending time educating these customers. As the economy gradually returned to normalcy, the Bank’s GNPA in this segment improved to 1.4% in FY23.

Co-lending partnerships

The Co-lending model is to improve the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and a greater reach of the NBFCs. DCB intends to partner with NBFCs that offer products not currently provided by the Bank or segments not served by the Bank.

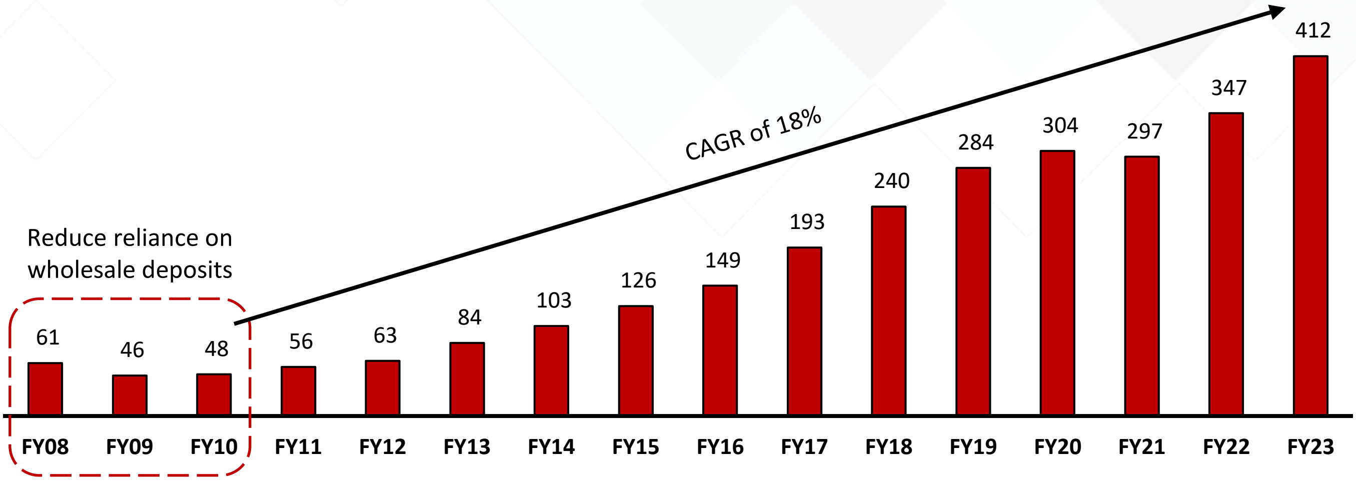
The Bank had started exploring Co-lending opportunities in FY22, and in Q1FY22, the Bank had a tie-up with two NBFCs for a gold loan. While the Bank already distributes the gold loan where the average ticket size is Rs. ~0.2 Mn and the co-lending partner’s average ticket size is Rs. 50,000-60,000, the Bank is partnering with the lenders where the Bank is not focused, and the co-lending partner have the ability to scale it up. The co-lending model works on an 80:20 ratio whereby 80% of the loan is deployed by the Bank and 20% by the originator.

The Bank has partnered with four new partners in FY23, thereby taking the total to six active co-lending partnerships. The contribution from the co-lending partnership to the total loan book is ~7% in FY23, and it is growing more than 50% YoY in Q1FY24.

Liability Mix

DCB deposits over FY08-10 declined by 11% CAGR led by decline in bulk deposits as management has strategically decided to reduce reliance on wholesale deposits. Since then, the Bank has consistently grown its deposit at a CAGR of 18% from FY10-FY23.

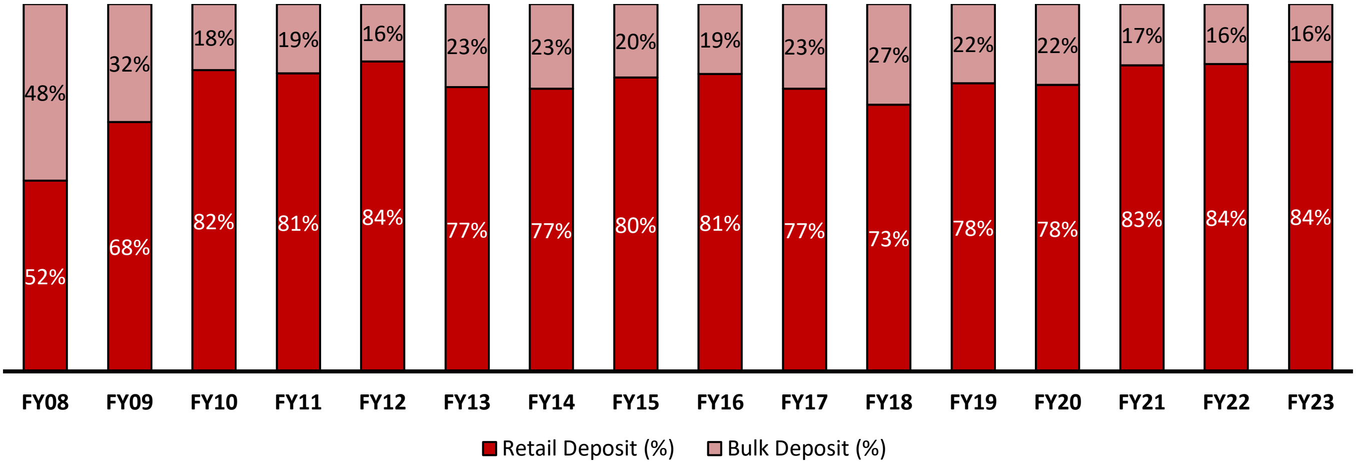
Deposit (Rs. Bn)



Source: Company, Keynote Capitals Ltd.

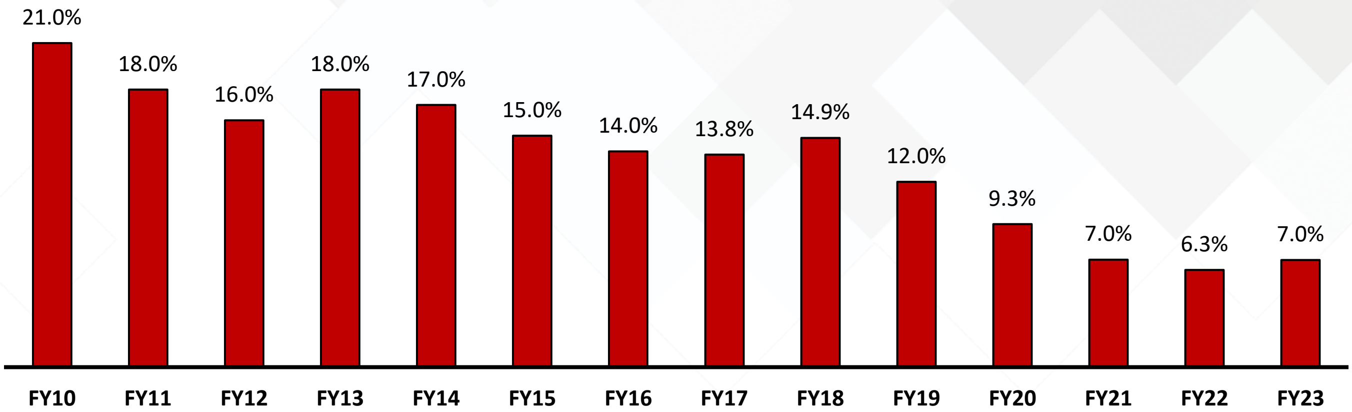
In the past, DCB relied heavily on wholesale deposits to meet its funding needs, with bulk deposits accounting for 48% of total deposits during FY07-08. In FY09, the steps initiated by the new management were to focus on low-cost deposits and shift towards retail deposits. DCB Bank's strategic focus was to emphasize the growth of retail deposits because they offer greater granularity and stability. Relying on wholesale liabilities can introduce greater volatility and result in higher funding costs.

Consistent improvement in retail deposit



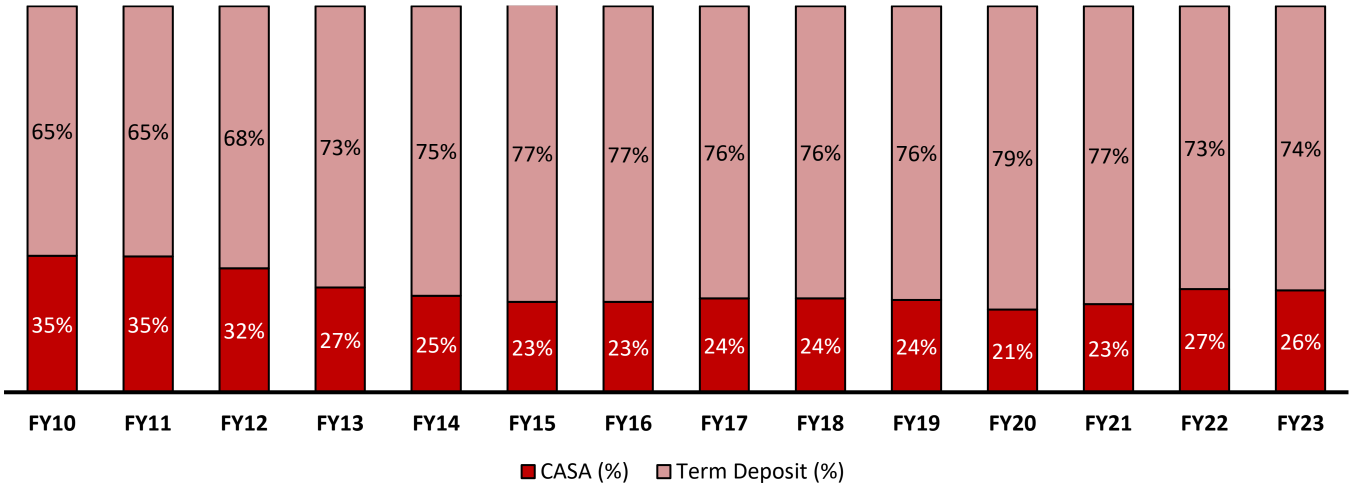
Source: Company, Keynote Capitals Ltd.

Granularization of the deposits - Contribution of top 20 depositors is decreasing



Source: Company, Keynote Capitals Ltd.

Deposit mix (%)



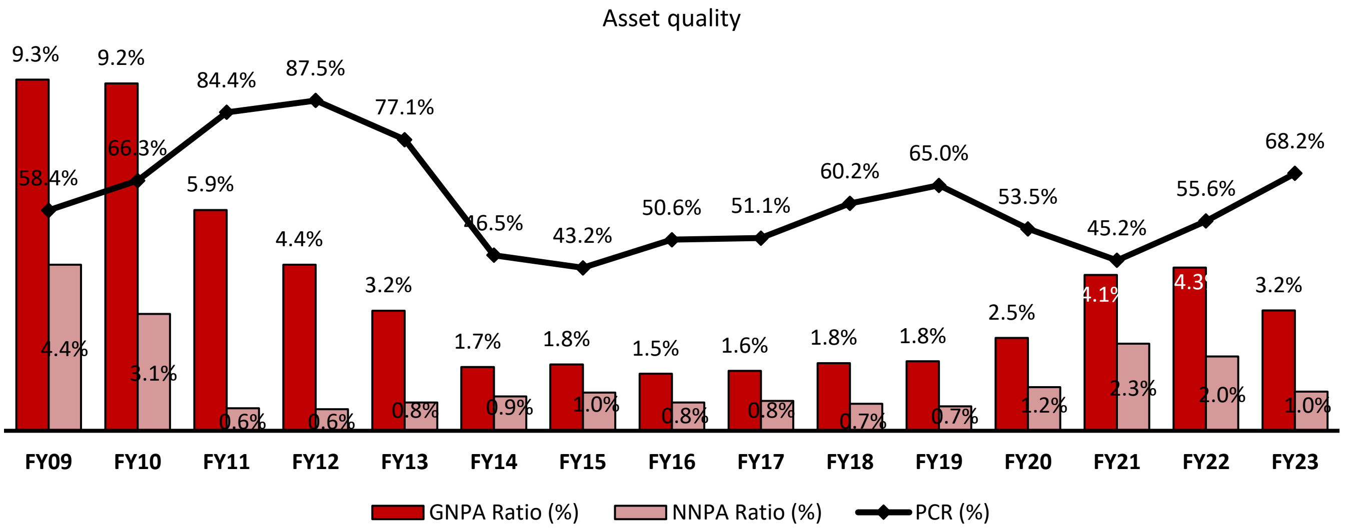
Source: Company, Keynote Capitals Ltd.

With travel restriction having eased, the Bank focused on garnering NRI deposits during FY23. NRI saving account grew by 20% and it contributes to ~9% of total deposits. Going forward, we expect DCB's deposit momentum to remain healthy given its improved branch network and frontline force facilitating better mobilization of deposits.

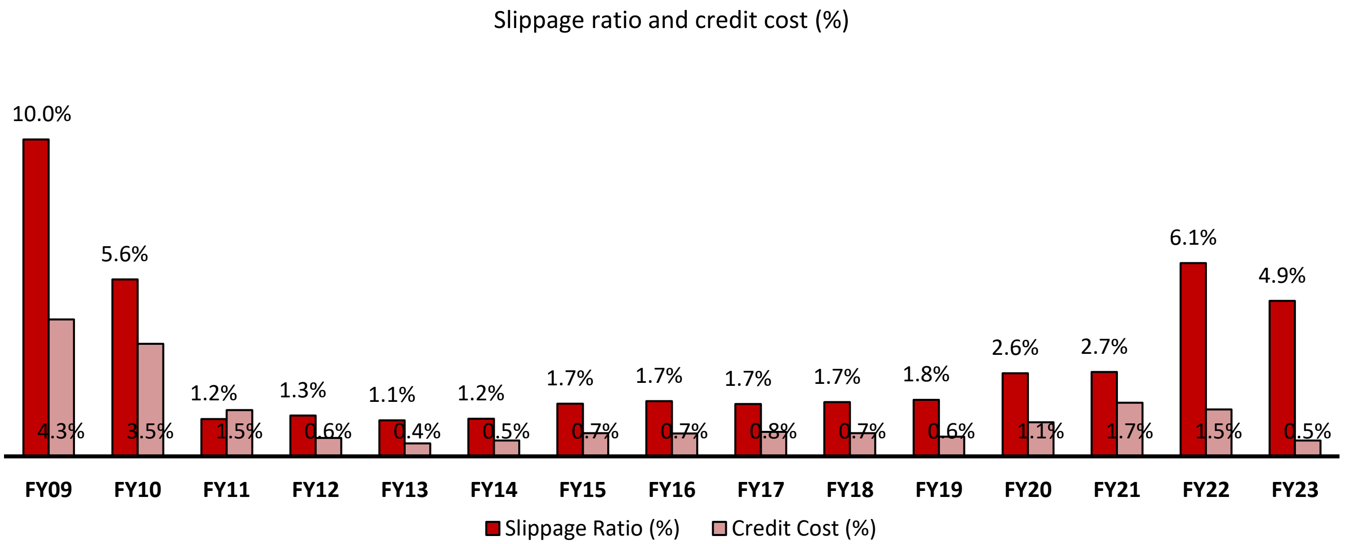
Asset quality

The Bank's asset quality had remained elevated from FY01-09 due to greater reliance on unsecured products, a high share of corporate loans and poor collections and monitoring processes. DCB recalibrated its loan portfolio beginning in April 2009 due to a change in management. The Bank re-align its loan mix towards secured lending, de-risking its unsecured personal loan, CV/CE segment, and corporate portfolio. These measures led to improvement in asset quality, with GNPA declining from 9.3% in FY09 to 1.8% in FY19, with NNPA falling to 0.7% in FY19 from 4.4% in FY09. Similarly, the fresh slippage ratio declined from 10% in FY09 to 1.8% in FY20. While in FY20, COVID-19 hit the economy, and the self-employed and small business and MSME segment catered by DCB has been significantly affected due to which the asset quality was impacted, leading to a rise in GNPA from 1.8% in FY19 to 4.3% in FY22. The Bank has witnessed strong collection and recoveries led by a lower slippage ratio in FY23 as the economy normalized and COVID-related challenges are behind. Going forward, management expects an improvement in the slippage ratio to continue as the pace of recovery and upgrade to remain healthy.

DCB has an in-house collections and recovery team at 304 locations with over 500 employees.



Source: Company, Keynote Capitals Ltd.



Source: Company, Keynote Capitals Ltd.

Segment-wise GNPA trend

	FY18	FY19	FY20	FY21	FY22	FY23
Mortgage	1.9%	1.9%	2.3%	3.8%	3.0%	2.0%
SME+MSME	1.4%	1.6%	2.6%	4.4%	5.3%	4.7%
Corporate	2.8%	1.9%	1.7%	1.7%	3.5%	7.1%
AIB	1.9%	2.4%	2.4%	4.3%	5.0%	3.9%
Gold Loan	3.0%	1.9%	1.4%	5.4%	8.9%	1.4%
Others	1.1%	1.2%	2.7%	4.7%	5.0%	3.6%

Source: Company, Keynote Capitals Ltd.

The Bank had implemented a Risk Assessment Model (RAM) of Crisil, which is being used to assess the credit rating of all business loans exceeding Rs. 10 Mn. This model helps in detecting the delinquencies at the initial stage. The Bank has formed a separate department independent of the business to monitor the transactions in all the corporate, AIB, SME/MSMEs to detect any warning signals.

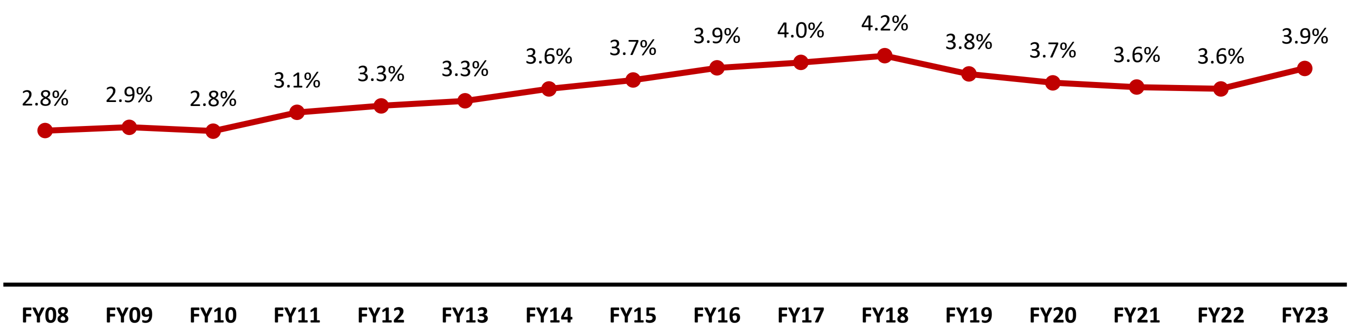
As collection efficiency steadily improved across the core segments throughout FY23, slippages moderated on a YoY basis. However, they remained elevated in comparison to normalized levels. A key reason for higher slippages was slippages from the gold loan book. Nevertheless, the management consistently emphasized that these slippages were not a cause for alarm and expected them to be recovered in the upcoming quarters. The management expects an improving trend in slippage and a strong recovery going forward will lead to further improvement in asset quality. The Bank expects the credit cost to remain at ~40 bps going forward.

KEYNOTE

Profit & loss statement

Post the change in management in April 2009, the strategic initiative the Bank took to replace a lot of high-interest earning assets like unsecured personal loans with retail home loans and SME loans, the NIM remained in the range of 2.8-2.9% from FY08-FY10. From FY11, the NIM started showing improvement due to a higher composition of retail, direct lending to priority sector segments, a decline in the Rural Infrastructure Development Fund (RIDF) (which the Bank used to buy for not lending to the priority sector), stable CASA, decline in bulk deposit, higher credit-deposit ratio and improvement in asset quality. Since FY11, NIM has performed better than what the Bank guides yearly in the concall. Going forward, the management expects NIM to be in the range of 3.70-3.75%, factoring the impact of an increase in interest rates, which will lead to a rise in the cost of funds.

Guided NIM (%) to be in the range of 3.70% to 3.75% going forward



Source: Company, Keynote Capitals Ltd

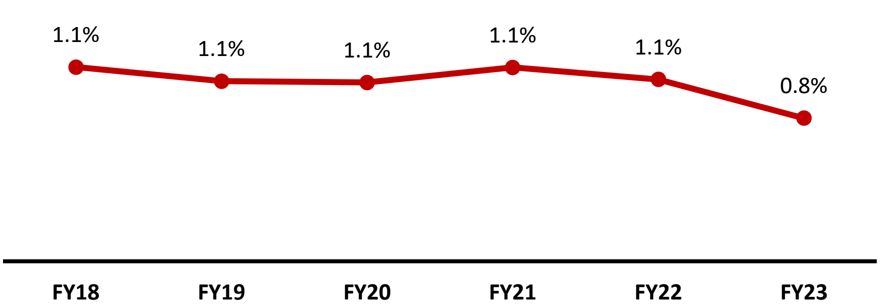
Fee and other income

The fee and other income of the Bank have grown at a CAGR of ~13% from FY13 to FY23. The fee income includes the processing fee, commission and brokerage from the bancassurance business, and other income.

Over the years, the Bank has continuously expanded its product basket to cross-sell to customers. The Bank has introduced different services and partnerships in insurance, mutual funds, credit cards, etc.

The fee income to average assets has remained at 1.1% over the last five years. In FY23, due to market conditions and regulatory changes, PSL income remained impacted, due to which fee income to average advances ratio fell to 0.8%. The Bank expects the fee income to average assets to be in the range of 1.05-1.10%.

Fees income to average assets



Source: Company, Keynote Capitals Ltd

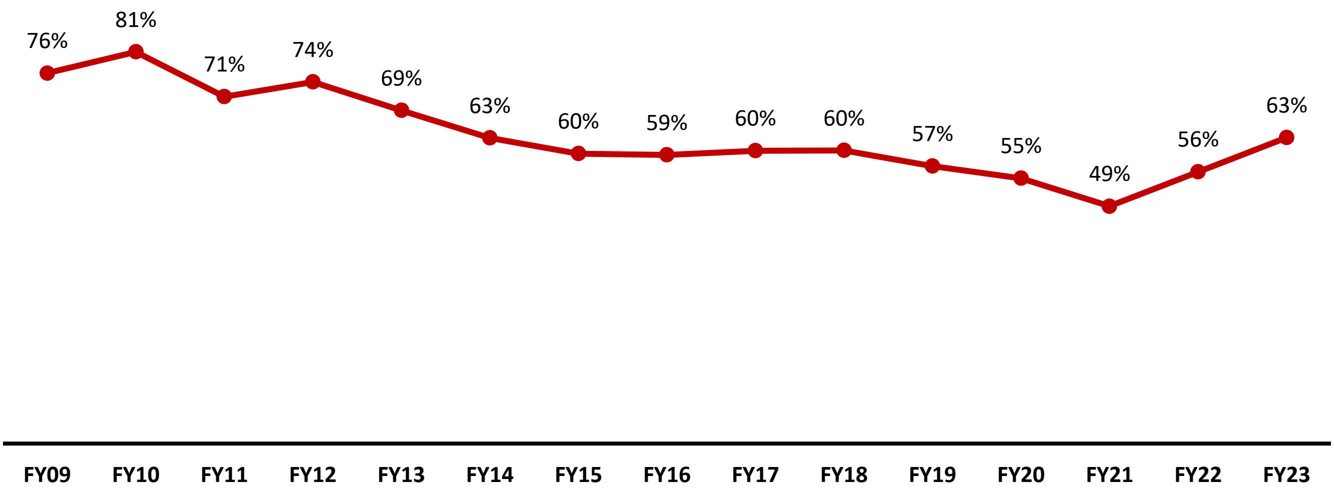
Cost-to-income ratio

The Bank’s cost-to-income ratio was significantly higher during FY09-10. Cost rationalization became a pivotal strategy under the new management. The Bank has initiated various steps to rationalize cost structure and improve efficiency. In a significant restructuring effort, it revamped its existing branches by reducing its physical footprint or relocating branches to areas with promising business prospects. At the same time, it exercised control over other operational expenses and optimized its workforce requirements, due to which the cost-to-income ratio declined from 81% in FY10 to 60% in FY15.

To enhance its competitiveness in the face of new banks and drive business growth, the Bank unveiled a strategic initiative to double its branch network in October 2015. Subsequently, the cost-to-income ratio has remained elevated, primarily due to the expansion plan involving a substantial increase in the number of branches, a significant addition of employees, heightened technology investments, and a strong focus on expanding digital and fintech partnerships.

During the phase of expansion and investment, DCB has shown resilience in the cost-to-income ratio, which remained at ~60% from FY16 to FY18. As the investment phase gets over, the Bank's cost-to-income ratio began to show improvement, reaching ~50% in FY21. However, in FY22, the Bank chose to accelerate once more, focusing on expanding capacity and reinforcing its team across various verticals to support future growth. Consequently, the cost-to-income ratio experienced an increase from 56% in FY22 to 63% in FY23. Nonetheless, the management has set a target for the cost-to-income ratio in FY25-26 at 55%.

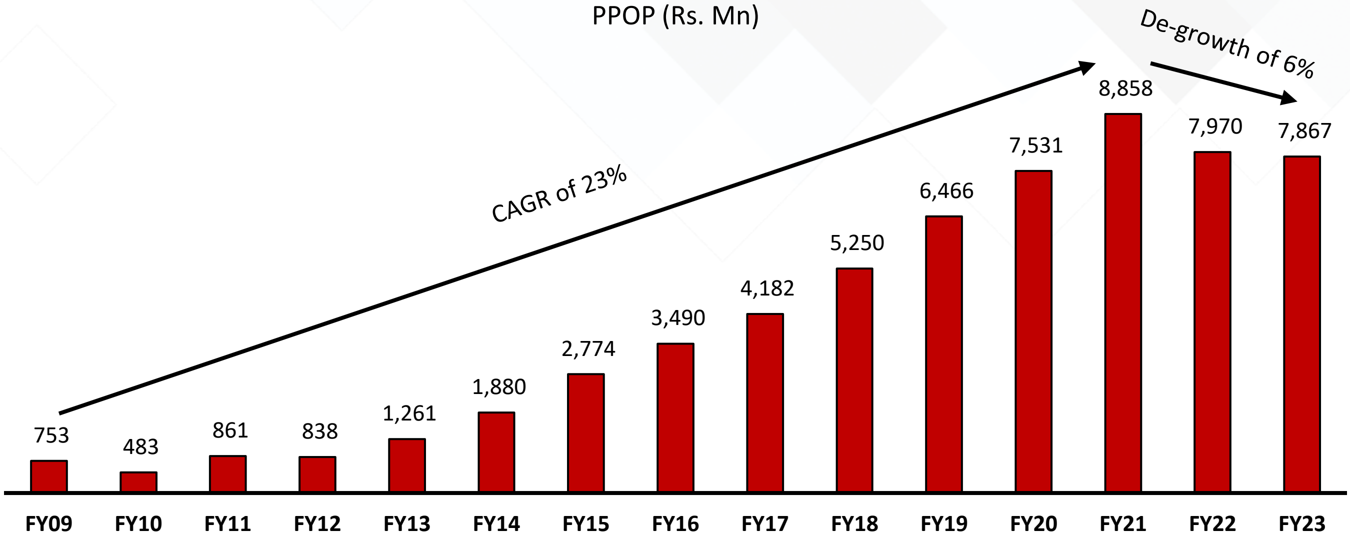
Cost-to-income ratio (%)



Source: Company, Keynote Capitals Ltd.

Due to the cost rationalization steps initiated by the new management in FY09 and continuous improvement in the cost-to-income ratio, the PPOP had seen a strong growth of 23% CAGR over FY09-FY21. In FY22, as the Bank decided to strengthen the team and aggressively expand the branches, it impacted the cost-to-income ratio, which led to a degrowth in PPOP from FY21 to FY23.

PPOP (Rs. Mn)

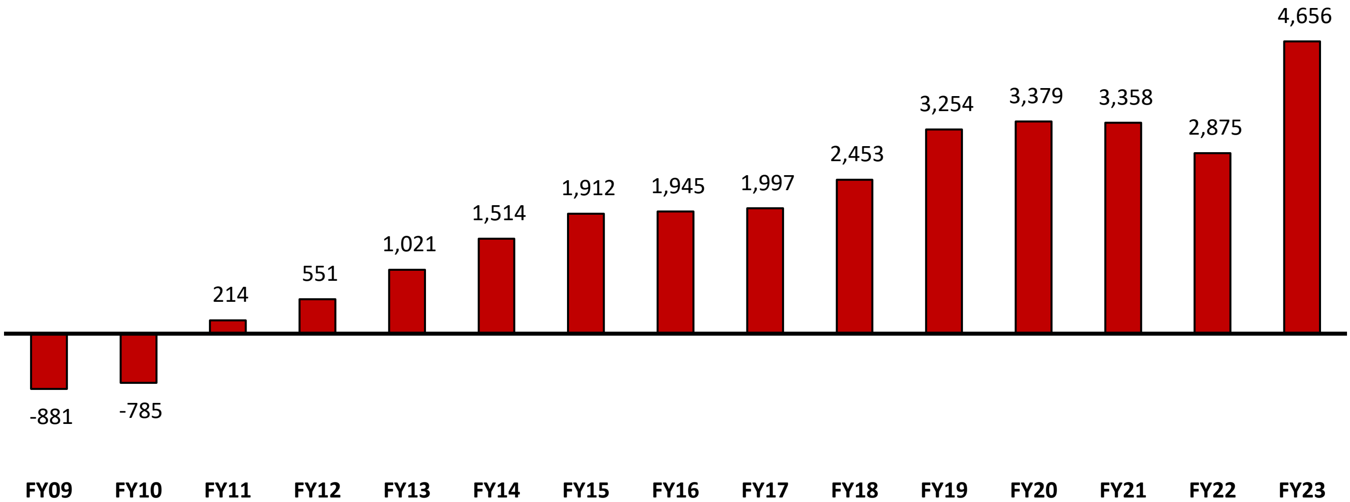


Source: Company, Keynote Capitals Ltd.

Given the significant improvement in asset quality from FY09-FY19, the bank's credit costs showed a consistent improvement trend, resulting in fewer setbacks in terms of provisions. Consequently, the bank transitioned from incurring losses to generating profits, achieving an impressive CAGR of 40% from FY11 to FY19.

However, the onset of the COVID-19 pandemic in FY20 significantly impacted the economy, particularly affecting the Bank's target market. As a response, DCB increased its provisions from Rs. 1.4 Bn in FY19 to Rs. 4.1 Bn in FY22, leading to a decline in the Bank's PAT. As the economy stabilized in FY23, the Bank's credit costs returned to pre-COVID levels, resulting in a noteworthy 62% YoY increase in PAT.

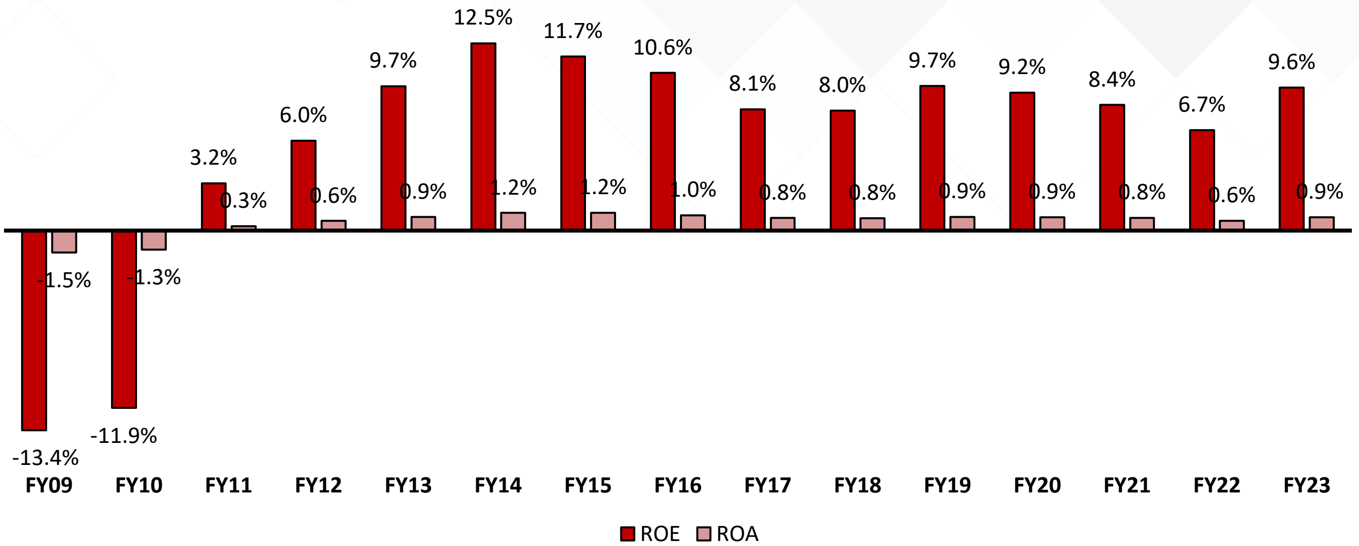
PAT (Rs. Mn)



Source: Company, Keynote Capitals Ltd.

The Bank has faced the turbulent times reasonably well and is now on the path to sustained growth momentum with various enablers in place. In FY23, the Bank posted the highest-ever net profit supported by strong loan growth, an increase in NIM, and improving credit costs, leading to lower provisions.

Return Ratios



Source: Company, Keynote Capitals Ltd.

Going forward, management expects strong loan growth, maintaining an NIM, increasing core fee income, improving the cost-to-income ratio and steady improvement in asset quality. All these factors will lead to higher earnings growth and enhanced return ratios.

Productivity Metrics

	FY18	FY19	FY20	FY21	FY22	FY23	CAGR (%)
Loan book (Rs. Mn)	2,03,367	2,35,680	2,53,453	2,57,372	2,90,960	3,43,810	11%
Deposits (Rs. Mn)	2,40,070	2,84,350	3,03,700	2,97,040	3,46,920	4,12,390	11%
Branches	318	333	336	352	400	427	6%
Growth YoY	21%	5%	1%	5%	14%	7%	
Employee	5,741	6,084	6,792	6,383	8,029	9,846	11%
Growth YoY	16%	6%	12%	-6%	26%	23%	
Profit (Rs. Mn)	2,453	3,254	3,379	3,358	2,875	4,656	14%
Employee per branch	18	18	20	18	20	23	
Loan per branch (Rs. Mn)	640	708	754	731	727	805	
Loan per employee (Rs. Mn)	35	39	37	40	36	35	
Deposit per branch (Rs. Mn)	755	854	904	844	867	966	
Deposit per employee (Rs. Mn)	42	47	45	47	43	42	
Profit per branch (Rs. Mn)	8	10	10	10	7	11	
Profit per employee (Rs. Mn)	0.43	0.53	0.50	0.53	0.36	0.47	

Source: Company, Keynote Capitals Ltd.

The Bank continues to invest in strengthening its frontline force across verticals and expanding the branches in tier II-VI cities. Over the years, the number of employees per branch has increased in the Bank, while if we see the productivity metrics, they have remained in the range. We expect operating leverage to kick in with branches maturing and improvement in the employee productivity ratio, led by higher loan book growth and improvement in the cost-to-income ratio.

Management

During 2008-09, DCB faced several operational issues led by frequent management changes. The Bank is scouting for a stable and experienced leader who can lead the Bank to new heights. Over the years, the Bank has hired a highly professional and experienced management team to restructure the business model and to focus on secured lending and tight control over cost. Once the Bank's business model and profitability were streamlined, the Bank internally promoted various people to the top management team to head the respective vertices of each segment.

From FY11-23, the average top management attrition was less than 4%, one of the lowest in the industry.

Name & Designation	Joining date	Profile
Mr. R. Venkattesh (Head – Operations, Information Technology, Human Resource & CIO)	Dec-05	Mr. Venkattesh has over 30 years of work experience in HR, Operations, and Technology and was associated with Standard Chartered Bank before joining DCB.
Mr. Manoj Joshi (Chief Compliance Officer and Chief Internal Vigilance)	Aug-06	Mr. Joshi has around 28 years of work experience in trade compliance, risk and corporate SME banking. He was associated with DCB Bank for over 17 years. He joined as a head of corporate banking and later built an SME/MSME business for the Bank. Currently, he is a Chief Compliance Officer.
Mr. Praveen Kutty (President – Head Retail & SME Banking)	Aug-07	Mr. Praveen has around 23 years of work experience in Retail and SME banking and was associated with DCB for over 16 years.
Mr. Bharat Sampat (Chief Financial Officer)	Sep-08	Mr. Sampat has over 35 years of work experience in Tax, Company Secretary, Investor Relations, Risk, Legal, Property and Administration functions and has been associated with DCB Bank for 13 years. Mr Sampat retired from the Bank in 2023.
Mr. Ajay Mathur (Head – Collections & Commercial Vehicles)	Sep-08	Mr. Mathur has over 30 years of work experience in vendor management, credit risk and business relationship management and has been associated with DCB Bank over 15 years.
Mr. Murali Natrajan (MD & CEO)	Apr-09	Mr. Murali has over 39 years of work experience in global banking and financial services, especially Retail and SME Banking and has been associated with DCB Bank for over 14 years. In his tenure, DCB Bank's balance sheet grew by ~9x, Income by 6x and net worth by more than 7x.
Mr. Sukesh Bhowal (Head –Mortgages, Gold Loan & Personal Loan)	Aug-09	Mr. Bhowal has over 27 years of work experience in sales and distribution and retail lending in mortgage and was associated with DCB Bank for over 13 years. He recently joined as a CEO of Motilal Oswal Home Finance.
Mr. Sridhar Seshadri (Chief Risk Officer)	Nov-09	Mr. Sridhar has over 39 years of work experience in Business Relationship Management, Risk Management, Corporate Finance, Banking, and Branch Banking and has been associated with DCB Bank for over 14 years.
Mr. Ravi Kumar (Chief Financial Officer)	Nov-09	Mr. Kumar has over 27 years of work experience in strategic planning, operational management and risk management and was associated with DCB Bank for over 14 years.

Mr. J. K Vishwanath (Head – Corporate, Construction Finance & SME Banking)	Jul-10	Mr. Vishwanath has over 29 years of work experience in credit and risk management and has been associated with DCB Bank for over 13 years. He joined as a credit officer to set up risk management and underwriting practices in Bank and now he is responsible for corporate and SME segment.
Mr. Krishna Ramasankaran (Head credit retail & SME)	Dec-10	Mr. Krishna has over 27 years of work experience in treasury management and audits and has been associated with DCB Bank for over 13 years. He was promoted in 2014 to Head the credit retail assets and is now heading the retail and SME segment.
Mr. N C Kaushal (Head – Digital Banking)	Nov-14	Mr. Kaushal has over 31 years of work experience in audit and compliance and has been associated with DCB Bank for over 8 years.
Mr. Bappa Roy (Head – Product Deposits, TPD & Gold Loan)	May-19	Mr. Roy has over 31 years of work experience and before joining DCB he was with Standard Chartered Bank where he was heading the retail segment.
Mr. Murali Rao (Chief Technology Officer)	Mar-20	Mr. Rao has over 22 years of work experience in digital and platforms.

Source: Company, Keynote Capitals Ltd

In 2024, Murali Natarajan will reach the completion of his 15-year tenure, coinciding with the maximum period permitted for an MD and CEO as per RBI guidelines. The Bank is currently in the process of selecting a new CEO. Consistent with the Bank's historical practice of nurturing talent from within, it appears that the new MD and CEO will likely emerge from the internal ranks.

DCB Bank's technological leap towards the future

The banking industry is undergoing rapid technological transformation, driven by evolving customer expectations for value-added services across various channels. Over the years, the Bank has been at the forefront of technology and digital banking with the rise in product innovation and customer adoption of digital technology.

To maintain a competitive edge since 2016, the Bank has restructured its IT strategy around four key pillars:

1. Continuous core application upgrades: Ongoing enhancements to core applications to facilitate digital transformation.

2. Optimizing mobile and web devices for customer Convenience.

3. Delivering innovative, secure, and efficient solutions: Providing dynamic, secure, and fast solutions to meet customer needs.

4. Infrastructure modernisation: Upgrading infrastructure to support business growth in a cost-effective and secure manner.

The Bank has introduced several new applications and upgrades, including FinnOne Neo for instalment loans, gold loan management system, smart credit to reduce credit card interest costs, e-DSR for sales force management, m-Collect for field collections, m-Credit for expedited MSME/SME loan processing, state-of-the-art data centre to drive decision making and improve business outcome, and loans on the Go (a mobile application for providing information on loans).

Additionally, the Bank has implemented Robotic Process Automation (RPA) with AI capabilities to handle repetitive tasks, resulting in cost reduction, error mitigation, and improved cycle times. It has also ventured into Application Programming Interface (API) Banking to align with industry trends in open banking. DCB has been actively investing in open banking and is an API banking service provider with over 200+ APIs to utilise the Sandbox.

These technological innovations streamline customer interactions, enhance security, offer personalized services based on real-time data, and open new avenues for customer engagement.

Over the years, the Bank has implemented a seamless onboarding process for customers with video-based personal discussion to improve turnaround time and CUBE (a digital end-to-end branch application for customer onboarding of deposit products).

Alliances

The Bank is continuously leveraging its fintech partnership to enhance its reach and attract new clients who have traditionally not been the Bank's clients. DCB has partnerships with six co-lending. The Bank has indicated that it will continue to expand its partnerships to boost loan growth.

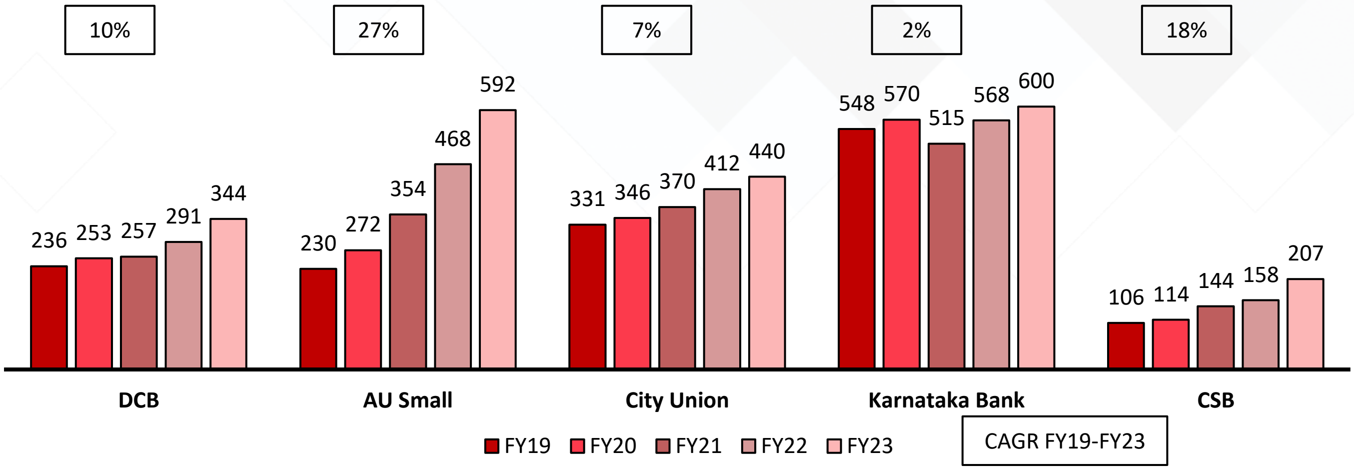
The Bank has integrated with the GOI Income Tax Portal to collect Income Tax and other Direct Taxes on behalf of the Central Board of Direct Taxes (CBDT).

KEYNOTE

Peer Comparison

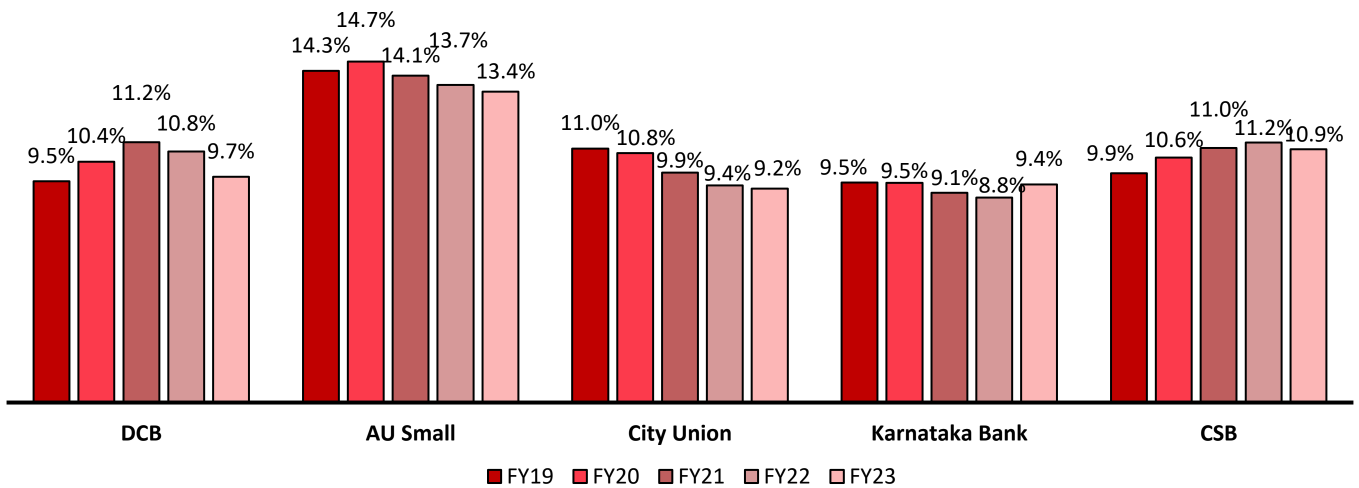
We reviewed DCB against its closest peers, AU Small, City Union, Karnataka Bank, and CSB.

Loan book (Rs. Bn) and CAGR for last four years



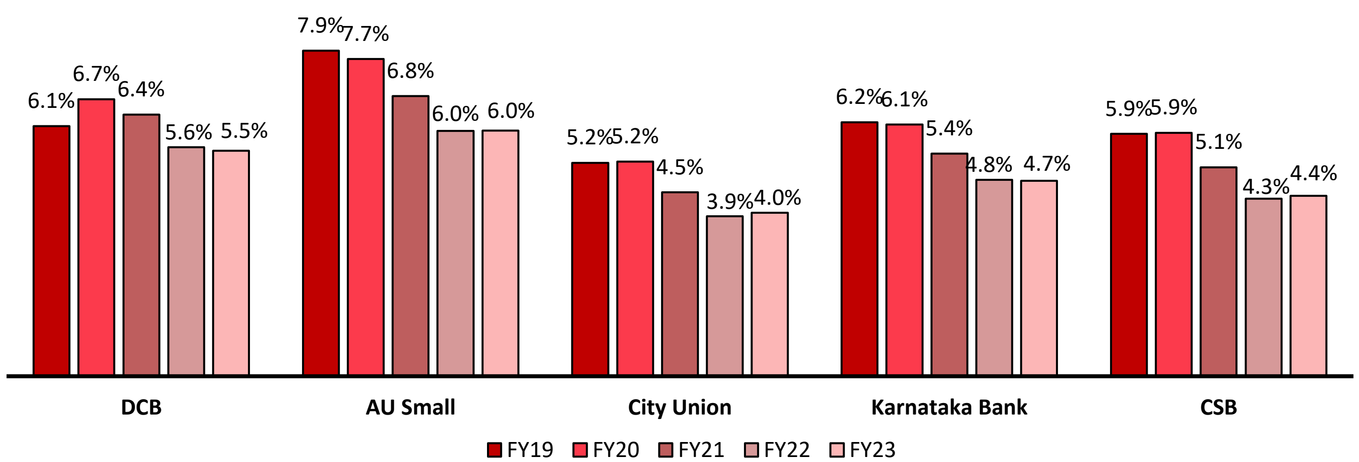
Source: Company, Keynote Capitals Ltd.,

Yield on advances (%)



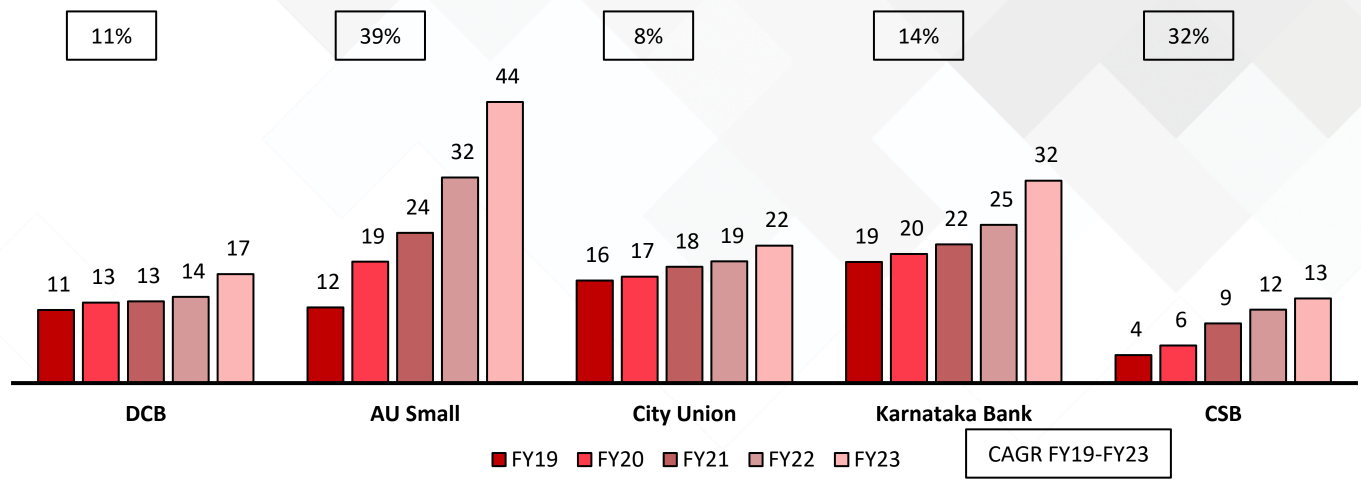
Source: Company, Keynote Capitals Ltd.

Cost of fund (%)



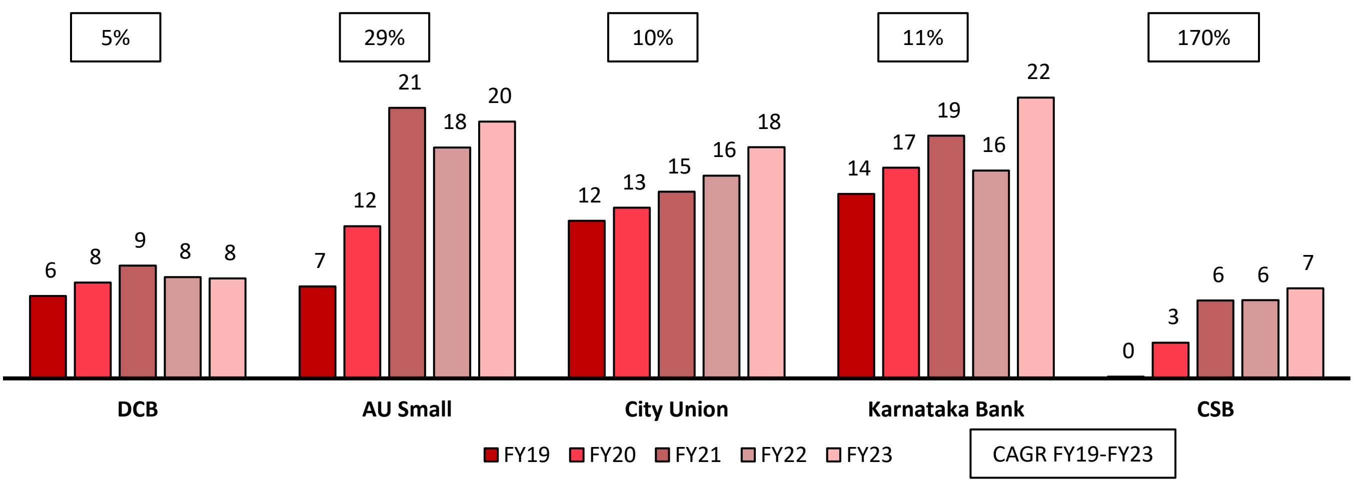
Source: Company, Keynote Capitals Ltd.

NII (Rs. Bn) and CAGR for last four years



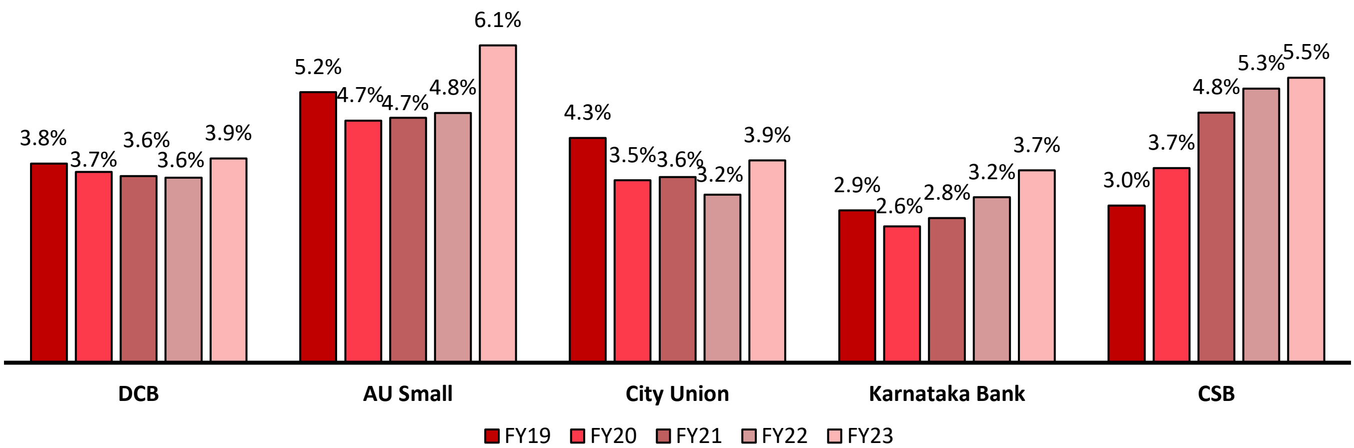
Source: Company, Keynote Capitals Ltd.

PPOP (Rs. Bn) and CAGR for last four years



Source: Company, Keynote Capitals Ltd.

NIM (%)



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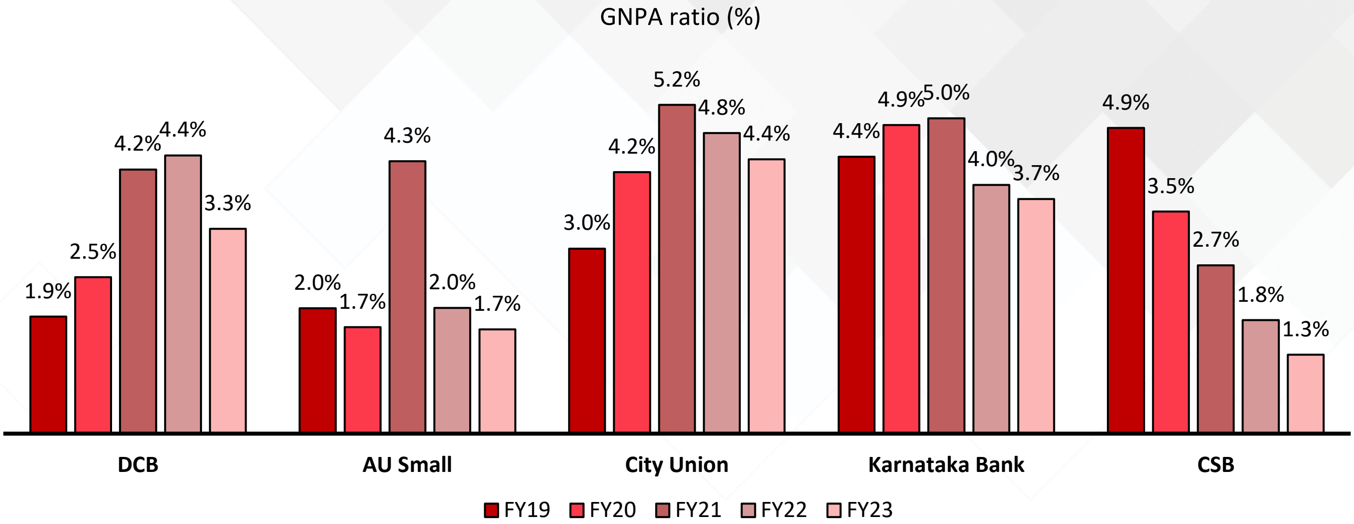

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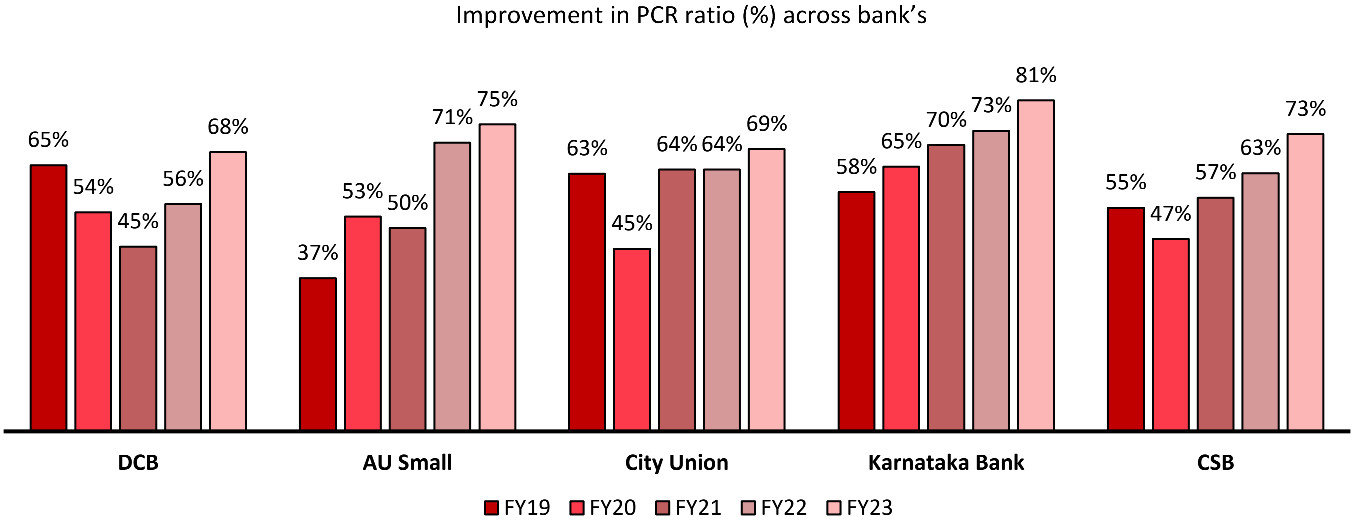

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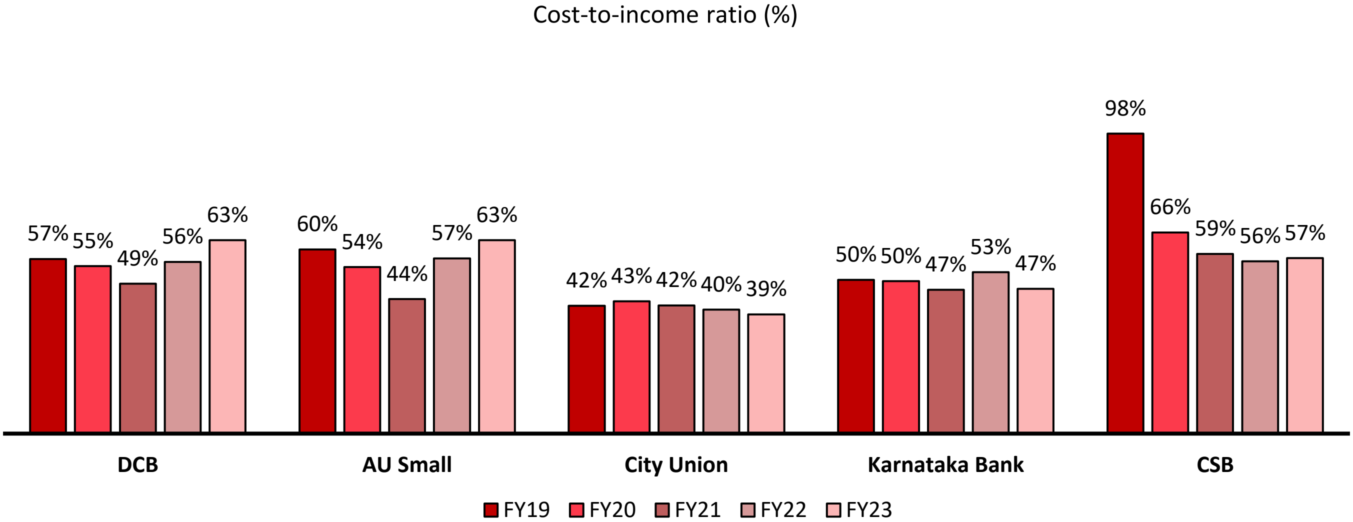
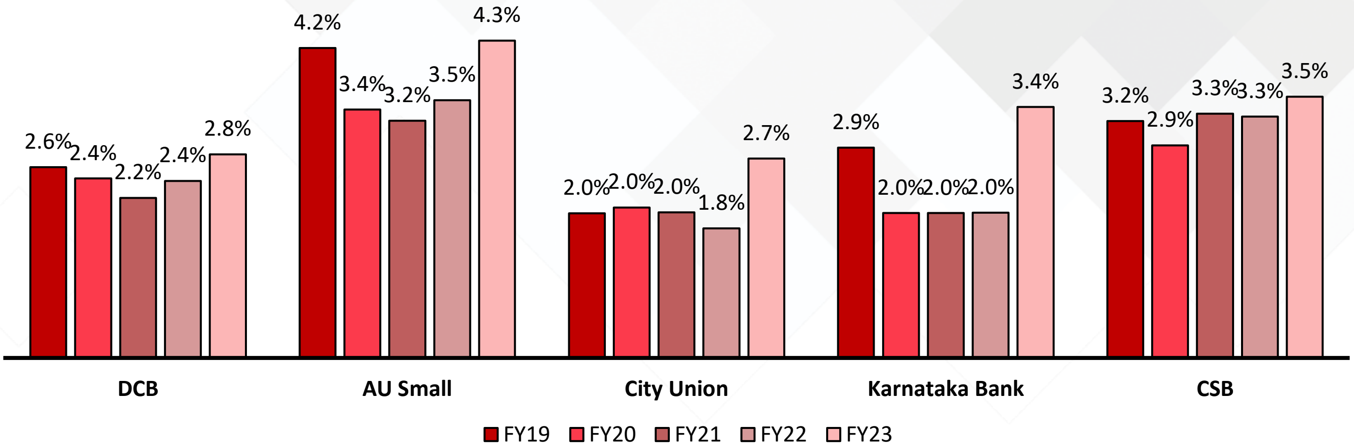


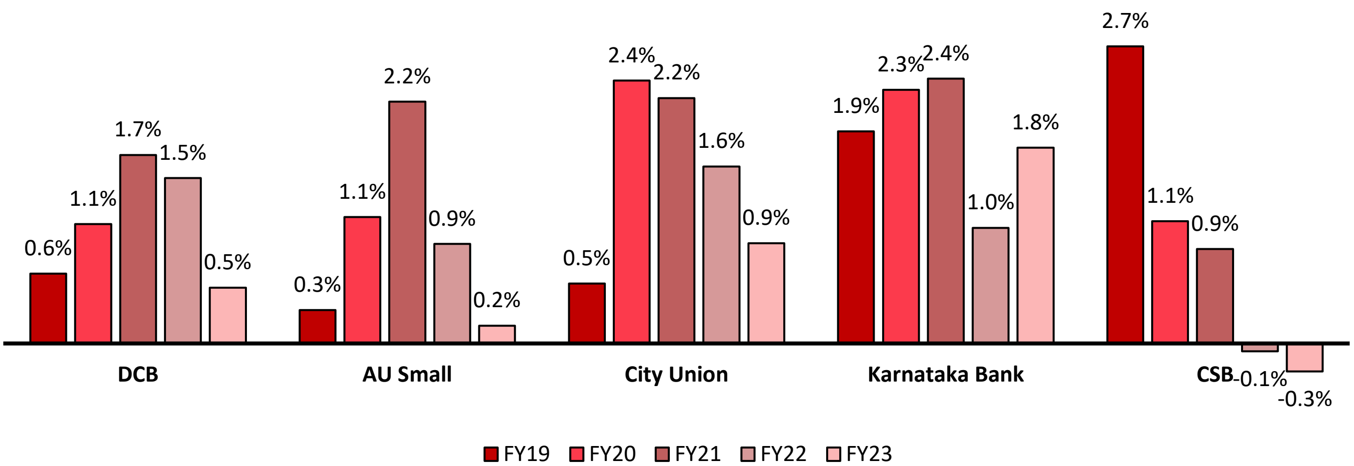
Source: Company, Keynote Capitals Ltd.

Cost-to-assets ratio (%)



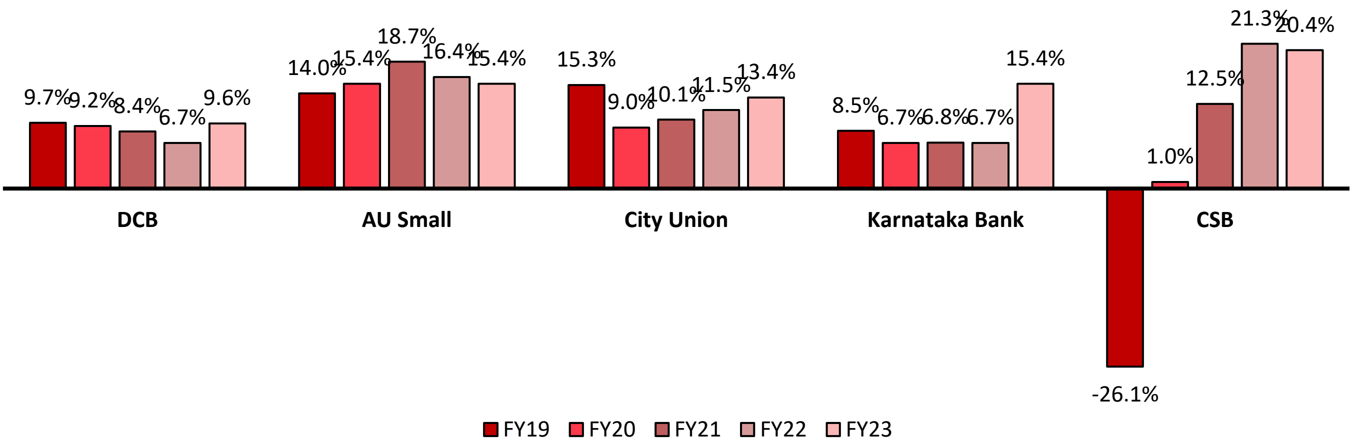
Source: Company, Keynote Capitals Ltd.

Improvement in credit cost across bank's



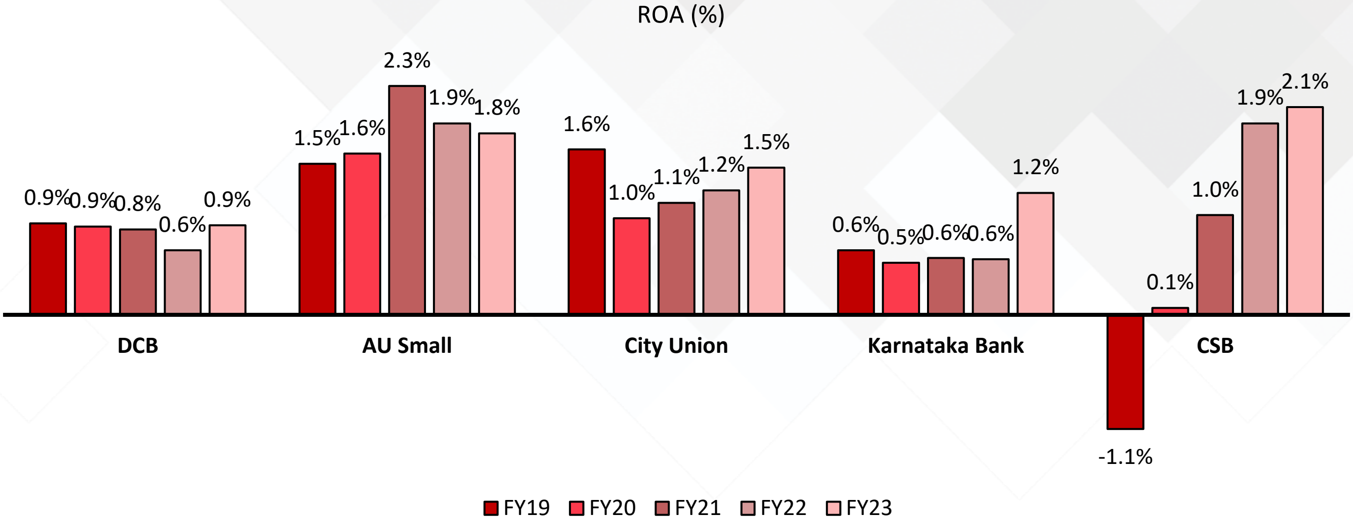
Source: Company, Keynote Capitals Ltd.

ROE (%)

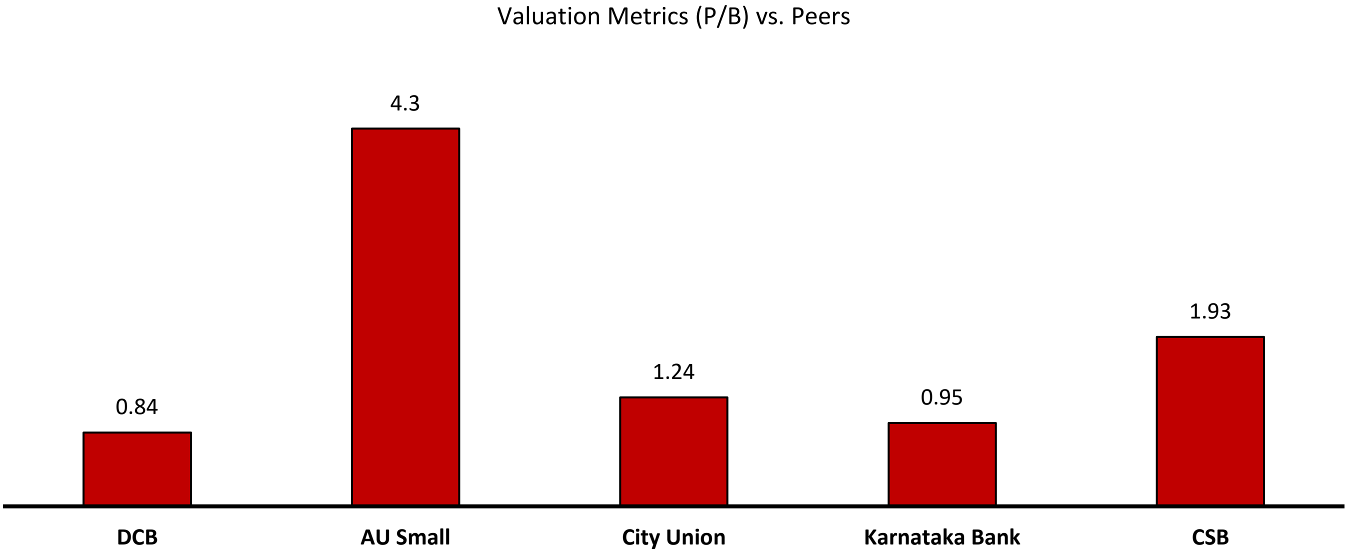


Source: Company, Keynote Capitals Ltd.

KEYNOTE



Source: Company, Keynote Capitals Ltd.



Source: Company, Keynote Capitals Ltd. CMP as of 8th Oct 2023

Opportunities

Doubling the loan book every three to four years

Under the leadership of Mr. Natrajan since FY10, the Bank reinvented its business model with greater emphasis on retail banking. The focus shifted towards small ticket (< Rs. 30 Mn) size loans and secured products (mortgage) to SMEs and mid-corporate in Tier II-VI cities, emphasising farm and priority segments lending.

Since FY11, DCB loan book had nearly doubled every three years, achieving an impressive 22% CAGR from FY11 to FY20. However, in 2021, the emergence of COVID-19 disrupted the economy, and the Bank encountered challenges due to a market slowdown. From FY20-22, the Bank had slowed down its pace as the self-employed segment, a focused area for the Bank, has been affected the most. In FY22, as the economy normalizes, the management aims to double its loan book over the next three to four years.

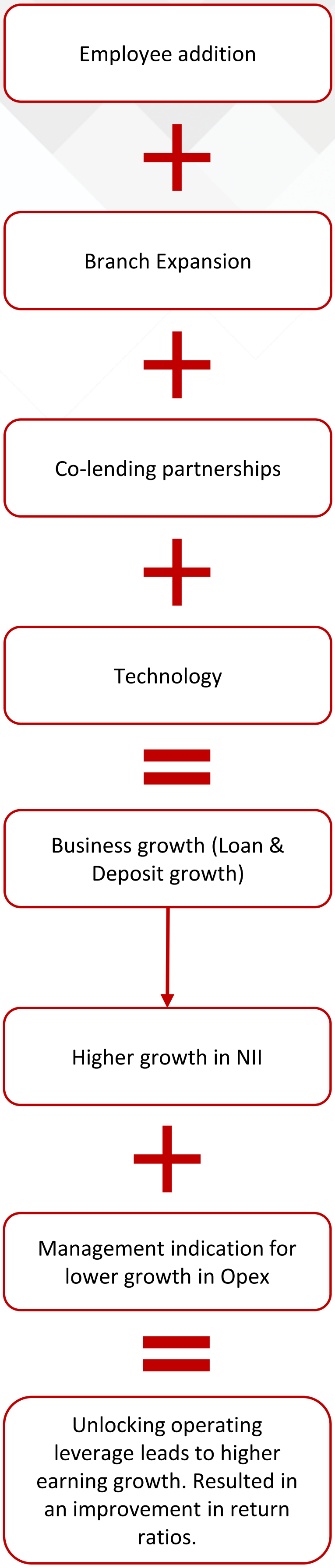
The focus segments of the Bank are mortgage, AIB, gold loan, and co-lending. These segments have witnessed a strong growth of over 20% CAGR from FY13-23, respectively, contributing ~80% of the loan book in FY23. While co-lending is a new segment growing by over 50% YoY in Q1FY24. Over the last two years, the Bank continued to build capacity and strengthen the team across verticals to support its growth aspirations.

The sectoral data released by the RBI also shows healthy growth momentum. In the last five months of FY24, from April to August, the MoM growth has remained strong, growing by at least 15% YoY. We expect the DCB loan book to grow by 20-22%, led by higher employee addition, branch expansion, increasing co-lending partnerships and leveraging technology.

Operating leverage to kick in

The Bank loan book growth has been 19% CAGR over FY11-23, which is captured in NII, growing by 20% CAGR over the same period. The operating cost over the same period has increased by 16%, while the past two years have seen costs rise due to aggressively expanding the team and branch expansion and lowering other income due to regulatory changes. Despite these headwinds, the Bank's PPOP continued its upward trajectory, growing at a steady 20% CAGR from FY11 to FY23. At the same time, the onset of the COVID-19 pandemic in FY20 significantly impacted the economy, particularly affecting the Bank's target market. The management expects NIM to be in the range of 3.70-3.75%. Notably, NIM has consistently outperformed the Bank's annual guidance since FY11. Additionally, The Bank expects fee income to total assets ratio between 1.05-1.10%, which will aid further growth in revenue.

The Bank has faced the turbulent times reasonably well and is now on the path to sustained growth momentum with various enablers in place. The management has guided the improvement of the cost-to-income ratio as costs normalized while income surged, laying the path for the long-awaited arrival of operating leverage.



Given the improvement in asset quality, the Bank's credit cost returned to pre-COVID levels, resulting in a noteworthy 62% YoY increase in PAT in FY23. We expect continued growth of a strong loan book fueled by higher income, which will result in operating leverage to kick in, leading to higher earning growth and improving the return ratios for the Bank.

Improvement in asset quality

The Bank recalibrated its loan portfolio beginning in April 2009 due to a change in management. DCB re-align its loan mix towards secured lending, de-risking its unsecured personal loan, CV/CE segment, and corporate portfolio. These measures led to improvement in asset quality, with GNPA declining from 9.3% in FY09 to 1.8% in FY19, with NNPA falling to 0.7% in FY19 from 4.4% in FY09. Similarly, the fresh slippage ratio declined from 10% in FY09 to 1.8% in FY19. While in FY20, COVID hit the economy, and the self-employed and small business MSME segment catered by DCB has been significantly affected due to which the asset quality was impacted, leading to a rise in GNPA from 1.8% in FY19 to 4.3% in FY22.

The Bank has witnessed strong collection and recoveries led by a lower slippage ratio in FY23 as the economy normalized and COVID-related challenges are behind. Management expects an improvement in the slippage ratio to continue as the pace of recovery and upgrade to remain healthy going forward.

A key reason for higher slippages was slippages from the gold loan book. Nevertheless, the management consistently emphasized that these slippages were not a cause for alarm and expected them to be recovered in the upcoming quarters. The management expects an improving trend in slippage and a strong recovery going forward will lead to further improvement in asset quality. The Bank expects the credit cost to remain at ~40 bps going forward.

Challenges

An elevated cost-to-income ratio can impact the profitability

DCB's cost-to-income ratio has increased from 50% in FY21 to 63% in FY23 as the Bank continues to build capacity and strengthen the team across verticals. However, management has guided to improve the cost-to-income ratio while the consistent rise in branches and employees across verticals to support growth can increase the cost, which can impact the profitability of the Bank.

Change in Management

As the current MD and CEO approaches retirement in CY24, the Bank faces the imperative task of identifying an appropriate successor to ensure a smooth transition in leadership.

KEYNOTE

Financial Statement Analysis

Profit & Loss

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Interest Income	**13,575**	**17,170**	**19,422**	**22,743**	**26,632**
Other Income	4,520	4,094	5,147	6,419	8,013
Net Income	18,095	21,264	24,569	29,162	34,645
Operating Expenses	10,126	13,397	14,742	16,622	19,055
Pre-Provision Operating Profit	**7,970**	**7,867**	**9,828**	**12,540**	**15,590**
Provisions	4,074	1,592	1,717	1,846	2,195
Profit Before Tax	**3,895**	**6,276**	**8,110**	**10,694**	**13,396**
Tax	1,020	1,620	2,028	2,674	3,349
Profit After Tax	**2,875**	**4,656**	**6,083**	**8,021**	**10,047**

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Share Capital	3,110	3,115	3,115	3,115	3,115
Reserves & Surplus	37,365	42,515	50,990	58,208	67,251
Networth	**40,475**	**45,630**	**54,105**	**61,324**	**70,366**
Deposits	3,46,917	4,12,389	4,93,465	5,85,272	6,74,925
Borrowings	40,818	41,181	47,585	58,625	99,098
Other Liabilities & Provisions	19,702	24,427	25,000	26,000	27,000
Total Liabilities	**4,47,926**	**5,23,649**	**6,20,154**	**7,31,220**	**8,71,389**
ASSETS					
Cash and Balance	40,908	23,684	32,350	37,660	60,460
Investments	90,507	1,25,825	1,37,090	1,53,100	1,70,030
Advances	2,90,958	3,43,807	4,19,445	5,03,334	5,93,934
Fixed Assets & Others	25,554	30,332	31,269	37,122	46,965
Total Assets	**4,47,926**	**5,23,649**	**6,20,154**	**7,31,220**	**8,71,389**

Source: Company, Keynote Capitals Ltd. Estimates

Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Growth YoY (%)					
Advance Growth (%)	13.0%	18.2%	22.0%	20.0%	18.0%
Deposit Growth (%)	16.8%	18.9%	19.7%	18.6%	15.3%
NII Growth (%)	5.5%	26.5%	13.1%	17.1%	17.1%
PPOP Growth (%)	-10.0%	-1.3%	24.9%	27.6%	24.3%
Ratios					
NIM (%)	3.4%	3.8%	3.6%	3.5%	3.5%
Cost to Income Ratio	56.0%	63.0%	60.0%	57.0%	55.0%
C/D Ratio	83.9%	83.4%	85.0%	86.0%	88.0%
CASA Ratio (%)	26.8%	26.4%	27.1%	28.3%	29.5%
ROE (%)	7.1%	10.2%	11.2%	13.1%	14.3%
ROA (%)	0.6%	0.9%	1.0%	1.1%	1.2%
Asset Quality					
GNPA	4.4%	3.3%	3.0%	2.7%	2.8%
NNPA	2.0%	1.4%	1.1%	1.0%	0.9%
PCR (%)	55.6%	68.2%	63.3%	63.0%	67.9%
Credit Cost (%)	0.9%	0.6%	0.5%	0.4%	0.4%
Valuation					
Book Value Per Share		146.5	173.7	196.9	225.9
Adjusted Book Value Per Share		130.6	158.9	180.7	208.7
P/BV (x)		0.85	0.72	0.63	0.55
Price-ABV (x)		0.96	0.79	0.69	0.60

Valuation based on Adj. P/B

Valuation	FY26E
Networth (Rs. Mn) – A	70,366
NNPA (Rs. Mn) – B	5,345
Adjusted Book Value (C = A - B)	65,021
No. of Shares (Mn) - D	312
Adj. Book Value Per Share (Rs.) – (E = C/D)	208.7
Adj. P/B – (CMP/E)	1.2
Target Price (Rs.)	250.4
CMP (Rs.)	123.4
% Upside/Downside	102.9%

Source: Company, Keynote Capitals Ltd. estimates

The Bank continues to invest in strengthening its frontline force across verticals and expanding the branches in tier II-VI cities, adding 75 branches and 3,463 employees over FY21-23 vs. just 19 branches and 299 employees during FY19-21. Following the expansion, management has guided to double the loan book in three to four years. We expect the loan book to grow 20-22% from FY23 to FY26, with a 3.70-3.75% NIM. The fee income will increase by 25% CAGR over FY23-26 as management has guided to improve fee income to average assets from 0.8% in FY23 to ~1% in FY26. As indicated by the management, operating cost growth would be lower than income growth, leading to higher growth in PPOP by ~26% CAGR over FY23-26. Given the management's guidance of improvement in credit cost leading to normalizing asset quality. The above assumptions will lead to a substantial 29% net profit CAGR over the same period. This will lead to a 13% CAGR growth in networth from FY23 to FY26.

Given the Bank's overall improvement, we ascribe an adjusted P/B multiple of 1.2x (~40% discount to average Adj. P/B for FY12 to FY23) for FY25E Adj. Book Value, implying an upside of ~103% from the CMP.

DEVIN PRAMOD JOSHI

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Our Recent Reports

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REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
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