BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 144 | ▲ 16%

DCB BANK | Banking | 28 September 2023

Improving prospects; BUY

- **Expect a strong 18% credit CAGR over FY23-FY25 (1.4x industry growth), supported by a better portfolio mix**
- **Margin to sustain at current level with both operational and credit cost forecast to gradually soften; expect a PPOP CAGR of 24%**
- **Improved return ratios along with growth can fetch higher valuations; we assume coverage with BUY and a TP of Rs 144 (0.8x FY25E ABV)**

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Targeting 2x growth in balance sheet: Muted SME/MSME disbursal along with lower participation in e-platform TReDS moderated growth in DCBB's advances to 19% YoY in Q1FY24. Going forward, we expect network expansion and a sharp focus on retail products such as mortgage, SME/MSME, gold loans, and AIB to support an 18% credit CAGR over FY23-FY25 (along with a 17% deposit CAGR). Management is confident of growth and aims to double the balance sheet in 3-4 years.

Margin to improve…: The recent NIM contraction (31bps QoQ in Q1FY24) was mainly due to a change in portfolio mix towards corporate loans and a higher cost of funds. We believe a majority of the increase in cost of funds is factored in and expect a recovery in AIB, mortgage and TReDS to help the bank maintain NIM at 3.72%/3.65% over FY24/FY25 – broadly in line with its target range of 3.7-3.75%.

…but C/I to remain high: On the operational front, the bank has invested heavily in network and human resources, adding 75 branches and 3,473 employees during FY22-FY23 vs. 19 branches and 298 employees over FY20-FY21. This has led to higher C/I ratios of 64%/63% in Q1FY24/FY23 vs. 48.5% in FY21. We expect sticky operating cost to keep the C/I ratio high at 62% in FY24 (and 59% in FY25).

Asset stress expected to ease: As most of the loan book emerged from moratorium in recent months, slippages were elevated at 4% of advances during Q1FY24. Management is confident of limiting slippages and expects asset quality to improve hereon. We model for controlled slippages of 3.6% in both FY24 and FY25, aiding improvement in GNPA/NNPA to 2.3%/0.9% over FY25. The bank's restructured book stood at 4% of loans in Q1, wherein it already has provisions of 14-15%. We pencil in credit cost of 54bps/60bps in FY24/FY25 vs. 50bps in FY23.

BUY, TP Rs 144: Baking in healthy growth, sustainable margins and improving asset quality, we expect DCBB to clock ROA/ROE of 1%/13% in FY25 vs. 0.96%/ 10.8% in FY23. However, sustainability of business growth would be key to watch. The stock is trading at 0.7x FY25E ABV. We assume coverage with BUY, valuing DCBB at 0.8x FY25E ABV for a TP of Rs 144, based on the Gordon Growth Model.

Key changes

Target	Rating
▲	▲

Ticker/Price	DCBB IN/Rs 125
Market cap	US$ 472.0mn
Free float	85%
3M ADV	US$ 2.7mn
52wk high/low	Rs 141/Rs 96
Promoter/FPI/DII	15%/12%/40%

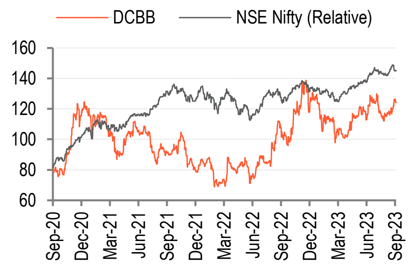
Source: NSE | Price as of 27 Sep 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Net interest income	17,170	20,026	23,175
NII growth (%)	26.5	16.6	15.7
Adj. net profit (Rs mn)	4,656	5,631	7,021
EPS (Rs)	15.0	18.1	22.5
Consensus EPS (Rs)	15.0	17.3	20.8
P/E (x)	8.3	6.9	5.5
P/BV (x)	0.8	0.8	0.7
ROA (%)	1.0	1.0	1.0
ROE (%)	10.8	11.7	13.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Fig 1 – Loan book trend

(Rs mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
AIB	62,609	67,589	72,523	80,107	82,300	31.4	2.7
Mortgage	125,219	133,927	140,761	150,588	158,569	26.6	5.3
Corporate banking	29,814	32,543	32,965	27,161	28,734	(3.6)	5.8
Gold Loan	14,907	15,020	13,845	13,065	12,771	(14.3)	(2.3)
Commercial vehicle	8,944	6,884	5,604	4,813	3,902	(56.4)	(18.9)
SME+MSME	26,833	29,727	29,998	28,880	23,768	(11.4)	(17.7)
Co-Lending	17,888	15,646	21,098	24,754	27,670	54.7	11.8
Others	11,926	11,578	12,856	14,440	17,028	42.8	17.9
Total	**298,140**	**312,914**	**329,650**	**343,807**	**354,740**	**19.0**	**3.2**

Source: Company, BOBCAPS Research

Fig 2 – Loan book distribution

Segment (%)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (bps)	QoQ (bps)
AIB	21.0	21.6	22.0	23.3	23.2	220	(10)
Mortgage	42.0	42.8	42.7	43.8	44.7	270	90
Corporate banking	10.0	10.4	10.0	7.9	8.1	(190)	20
Gold Loan	5.0	4.8	4.2	3.8	3.6	(140)	(20)
Commercial vehicle	3.0	2.2	1.7	1.4	1.1	(190)	(30)
SME+MSME	9.0	9.5	9.1	8.4	6.7	(230)	(170)
Co-Lending	6.0	5.0	6.4	7.2	7.8	180	60
Others	4.0	3.7	3.9	4.2	4.8	80	60

Source: Company, BOBCAPS Research

Fig 3 – Deposit trend

(Rs mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
CASA	100,240	108,460	109,110	108,960	111,670	11.4	2.5
Resident	195,445	201,861	224,757	238,799	251,870	28.9	5.5
Non-Resident	32,574	37,082	38,603	40,963	41,395	27.1	1.1
Inter-Bank	22,551	22,197	22,590	23,668	25,155	11.5	6.3
Term Deposits	250,570	261,140	285,950	303,430	318,420	27.1	4.9
Total Deposits	**350,810**	**369,600**	**395,060**	**412,390**	**430,090**	**22.6**	**4.3**

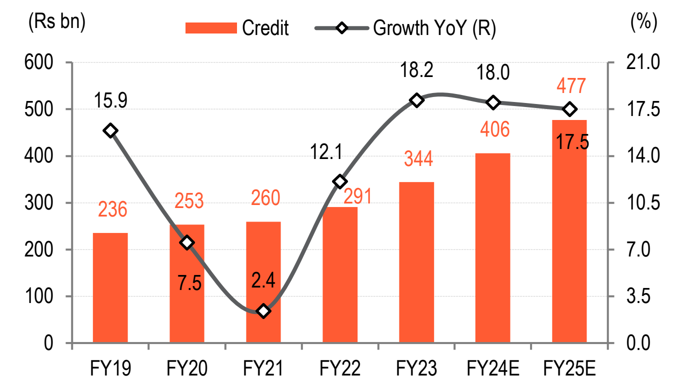
Source: Company, BOBCAPS Research

Fig 4 – Deposit distribution

(%)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (bps)	QoQ (bps)
CASA	28.6	29.3	27.6	26.4	26.0	(261)	(46)
Resident	55.7	54.6	56.9	57.9	58.6	285	66
Non-Resident	9.3	10.0	9.8	9.9	9.6	34	(31)
Inter-Bank	6.4	6.0	5.7	5.7	5.8	(58)	11
Term Deposits	71.4	70.7	72.4	73.6	74.0	261	46
Total Deposits	100.0	100.0	100.0	100.0	100.0	0	0

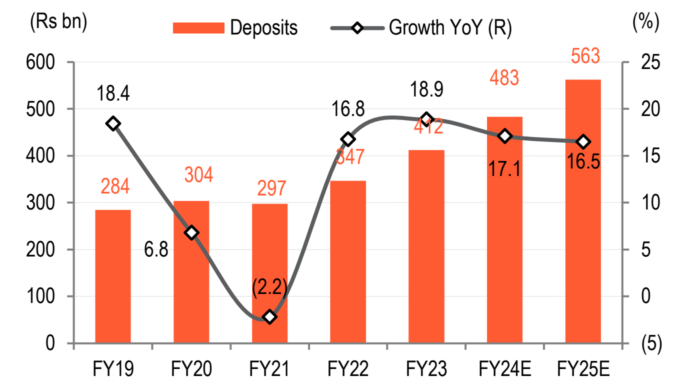
Source: Company, BOBCAPS Research

Fig 5 – Expect a 18% credit CAGR for FY23-FY25E…



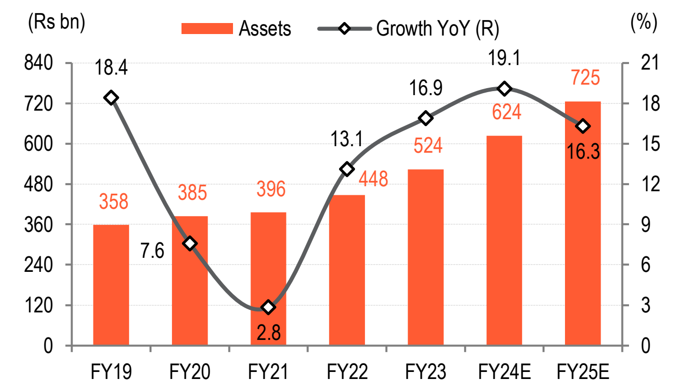
Source: Company, BOBCAPS Research

Fig 6 – …and 17% deposit CAGR



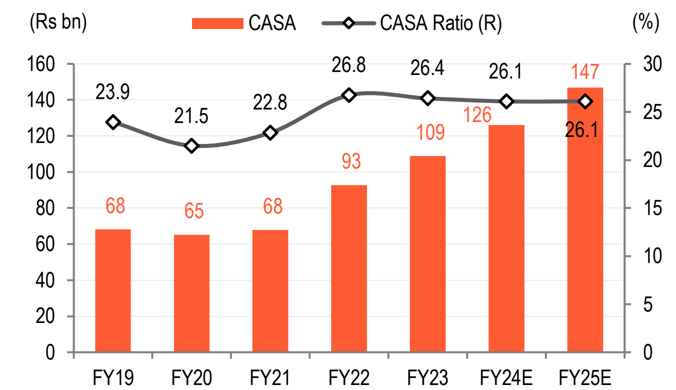
Source: Company, BOBCAPS Research

Fig 7 – Asset growth to remain healthy



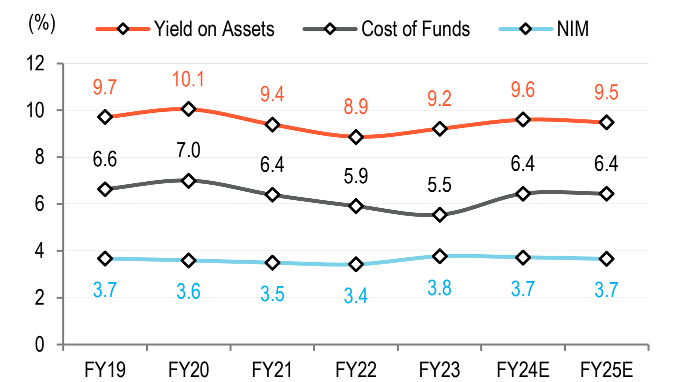
Source: Company, BOBCAPS Research

Fig 8 – CASA ratio to hold at 26% levels



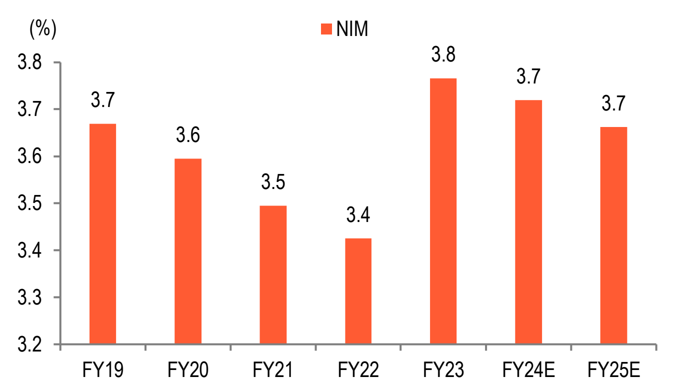
Source: Company, BOBCAPS Research

Fig 9 – Cost of funds on the rise



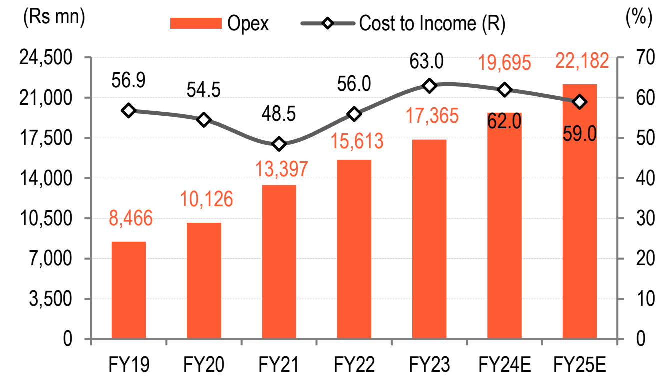
Source: Company, BOBCAPS Research

Fig 10 – Focus on granular retail business to support NIM



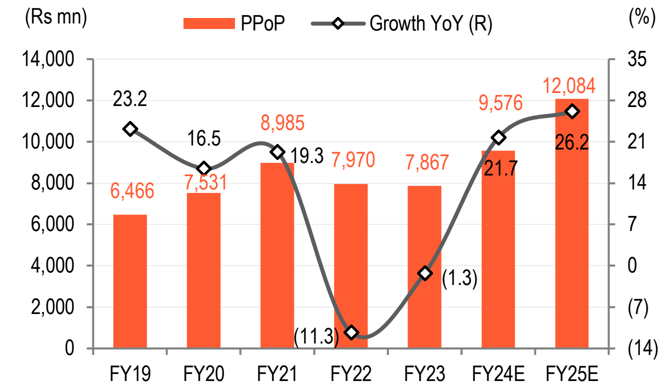
Source: Company, BOBCAPS Research

Fig 11 – Opex to normalise



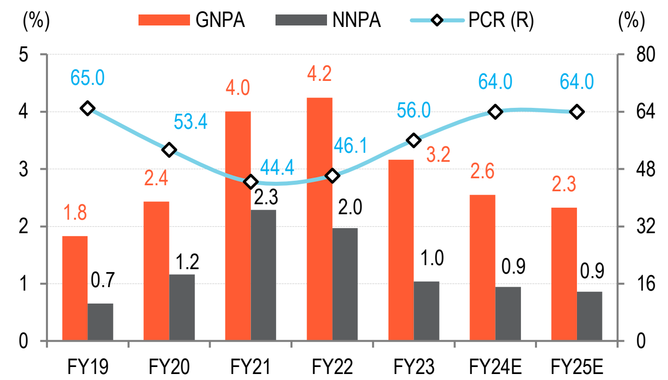
Source: Company, BOBCAPS Research

Fig 12 – PPOP growth to come off a low base



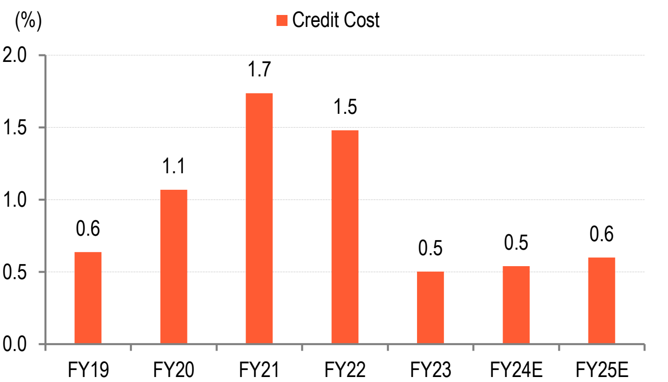
Source: Company, BOBCAPS Research

Fig 13 – Asset quality improving



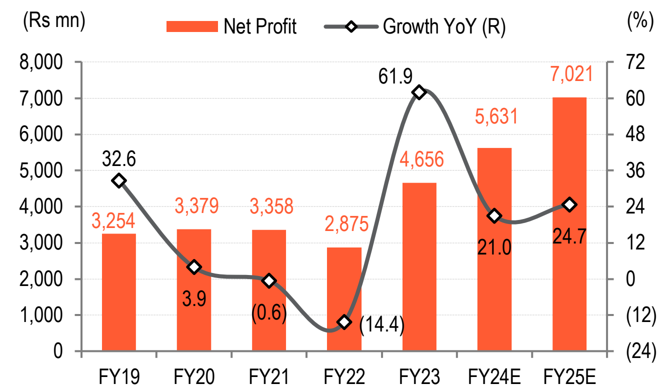
Source: Company, BOBCAPS Research

Fig 14 – Credit cost to remain stable



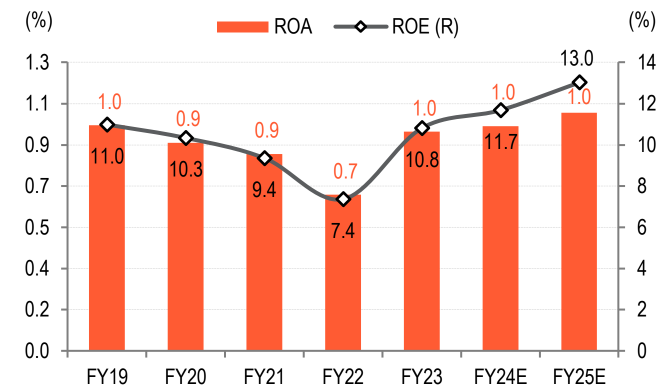
Source: Company, BOBCAPS Research

Fig 15 – Expect a 23% PAT CAGR



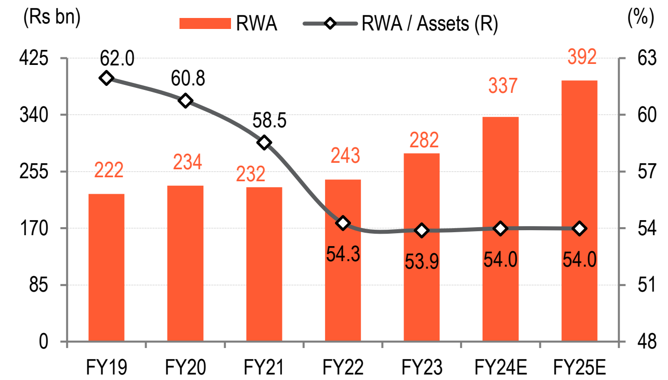
Source: Company, BOBCAPS Research

Fig 16 – Return ratios improving but still below peers



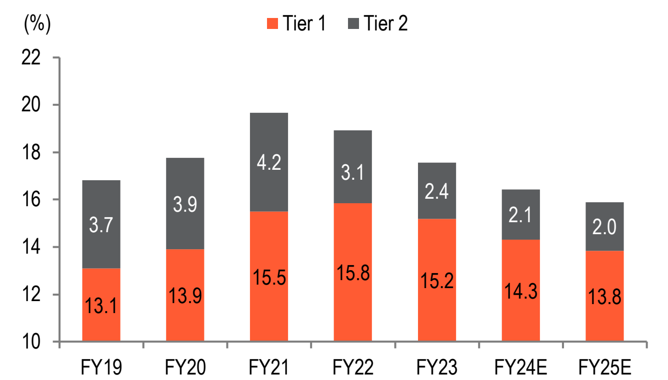
Source: Company, BOBCAPS Research

Fig 17 – Stable RWA-to-asset ratio to aid CAR



Source: Company, BOBCAPS Research

Fig 18 – Well capitalised to fund credit demand



Source: Company, BOBCAPS Research

Valuation methodology

Key forecasts

DCBB has invested heavily in network and human resources, adding 75 branches and 3,473 employees during FY22-FY23 vs. just 19 branches and 298 employees over FY20-FY21. Following this expansion, management has set itself a medium-term (3-4-year) target of doubling the balance sheet. We expect growing market penetration together with a focus on the mortgage, agri & inclusive banking (AIB), gold loan and SME/MSME segments to support a credit CAGR of 18% over FY23-FY25. Deposits are estimated to log a 17% CAGR for the same period (vs. expected industry growth of 13-14% for both deposit and credit).

We model for an NII CAGR of 16.2% and higher 24% growth in other income backed by core fees. Management expects to register NIM in the range of 3.7-3.75% during FY24 and has attributed the 31bps QoQ contraction during Q1FY24 to a temporary spike in competitive intensity in TReDS business. The bank's focus on high yielding business is likely to support margins, though management expects some pressure from deposit repricing. We believe a majority of the increase in cost of funds is factored in and expect a recovery in AIB, mortgage and TReDS to help the bank maintain NIM at 3.72%/3.65% over FY24/FY25.

The aggressive branch expansion over the last two years pushed DCBB's C/I ratio up to 64%/63% in Q1FY24/FY23 vs. 48.5% in FY21. Management is guiding for slower additions of 25-30 branches ahead and expects leverage from higher volumes to normalise operating cost. However, we believe operating cost will remain sticky as the bank's core focus lies in the retail business. We thus model for a CI ratio of 59% by FY25 while the bank expects to approach 55% over the next 3-4 years. Baking in sticky operational costs, PPOP is forecast to log a 24% CAGR over FY23-FY25 on a lower base.

DCBB's asset quality has witnessed substantial improvement in FY23 with controlled slippages and increased upgrades and recovery. Q1FY24, however, saw some deterioration as the moratorium benefit on its mortgage portfolio came to an end. Management is confident of limiting slippages and expects asset quality to improve hereon. We model for slippages of 3.6% in both FY24 and FY25, aiding improvement in GNPA/NNPA to 2.3%/0.9% over FY25 with PCR of 65%.

The bank's restructured book stood at 4% of loans in Q1, but management has indicated that provisions of 14-15% are in place, which provide some cushion towards credit cost. We pencil in credit cost of 54bps/60bps over FY24/FY25 vs. 50bps in FY23. The bank is well capitalised with CAR of 17.1% (tier-1 at 14.8%) as of Jun'23, and we estimate healthy levels of 14%/16% in FY24/FY25.

BUY, TP Rs 144

In our view, DCBB's recent network buildout and focus on high yielding segments such as AIB and SME/MSME could help the bank expand its balance sheet in line with guidance. We believe operational efficiency would improve, albeit gradually, and estimate ROA/ROE of 1%/13% in FY25 vs. 0.96%/11% in FY23. The stock is trading at 0.7x FY25E ABV. We assume coverage with a BUY rating, valuing DCBB at 0.8x FY25E ABV for a TP of Rs 144, based on the Gordon Growth Model.

Fig 19 – Key operational assumptions

Parameter (%)	FY22	FY23	FY24E	FY25E
Advances Growth	12.1	18.2	18.0	17.5
NII Growth	5.5	26.5	16.6	15.7
PPoP growth	(11.3)	(1.3)	21.7	26.2
PAT growth	(14.4)	61.9	21.0	24.7
NIM	3.4	3.8	3.7	3.7
GNPA	4.2	3.2	2.6	2.3
CAR	18.9	17.6	16.4	15.9

Source: Company, BOBCAPS Research

Fig 20 – Key valuation assumptions: Gordon growth model

Particulars	
Cost of equity (%)	12.5
Blended ROE (%)	11.2
Initial high growth period (yrs)	10.0
Payout ratio of high-growth phase (%)	20.0
Long-term growth (%)	4
Long term dividend payout ratio (%)	60
Justified P/BV Multiple (x)	0.8

Source: Company, BOBCAPS Research

Key risks

- Inability of the bank to manage a higher cost of funds with faster deposit repricing would represent a key downside risk.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Axis Bank	AXSB IN	38.4	1,025	1,155	BUY
DCB Bank	DCBB IN	0.5	125	144	BUY
Federal Bank	FB IN	3.9	151	165	BUY
HDFC Bank	HDFCB IN	140.1	1,527	2,061	BUY
ICICI Bank	ICICIBC IN	80.2	943	1,015	HOLD
Indusind Bank	IIB IN	13.6	1,436	1,755	BUY
Kotak Mahindra Bank	KMB IN	42.7	1,765	2,122	HOLD
RBL Bank	RBK IN	1.8	245	233	HOLD
State Bank of India	SBIN IN	64.1	590	729	BUY

Source: BOBCAPS Research, NSE | Price as of 27 Sep 2023

Glossary

Glossary of Abbreviations			
AUCA	Advance Under Collection Account	**LCR**	Liquidity Coverage Ratio
AIB	Agri & Inclusive Banking	**MCLR**	Marginal Cost of Funds-based Lending Rate
ARC	Asset Reconstruction Company	**MFI**	Microfinance Institution
BRDS	Bills Rediscounting Scheme	**MTM**	Mark to Market
CASA	Current Account and Savings Account	**NII**	Net Interest Income
CAR	Capital Adequacy Ratio	**NIM**	Net Interest Margin
CET1	Common Equity Tier 1	**NNPA**	Net Non-Performing Assets
CD	Credit-Deposit Ratio	**PCR**	Provision Coverage Ratio
C/I	Cost-Income Ratio	**PPOP**	Pre-Provision Operating Profit
CRB	Commercial and Rural Banking	**PSU**	Public Sector Unit
EBLR	External Benchmark-based Lending Rate	**RWA**	Risk-weighted Assets
ECL	Expected Credit Loss	**SLR**	Statutory Liquidity Ratio
GNPA	Gross Non-Performing Assets	**SMA**	Special Mention Account
IBPC	Interbank Participation Certificate	**SME**	Small and Medium-sized Enterprises
LAP	Loans against Property		

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Net interest income	**12,866**	**13,575**	**17,170**	**20,026**	**23,175**
NII growth (%)	1.7	5.5	26.5	16.6	15.7
Non-interest income	4,585	4,520	4,094	5,163	6,273
Total income	17,451	18,095	21,264	25,189	29,449
Operating expenses	8,466	10,126	13,397	15,613	17,365
PPOP	8,985	7,970	7,867	9,576	12,084
PPOP growth (%)	19.3	(11.3)	(1.3)	21.7	26.2
Provisions	4,457	4,074	1,592	2,024	2,647
PBT	4,528	3,895	6,276	7,553	9,437
Tax	1,170	1,020	1,620	1,921	2,416
Reported net profit	**3,358**	**2,875**	**4,656**	**5,631**	**7,021**
Adjustments	0	0	0	0	0
Adjusted net profit	**3,358**	**2,875**	**4,656**	**5,631**	**7,021**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Equity capital	3,105	3,110	3,115	3,115	3,115
Reserves & surplus	34,481	37,378	42,546	47,614	53,933
Net worth	37,586	40,488	45,661	50,729	57,048
Deposits	297,039	346,917	412,389	482,908	562,587
Borrowings	44,823	40,818	41,181	47,358	53,515
Other liab. & provisions	16,574	19,702	24,427	42,678	52,288
Total liab. & equities	**396,021**	**447,926**	**523,659**	**623,674**	**725,439**
Cash & bank balance	30,393	40,908	23,684	39,214	45,793
Investments	84,137	90,507	125,825	142,656	160,492
Advances	259,592	290,958	343,807	405,693	476,689
Fixed & Other assets	21,899	25,554	30,342	36,111	42,465
Total assets	**396,021**	**447,926**	**523,659**	**623,674**	**725,439**
Deposit growth (%)	(2.2)	16.8	18.9	17.1	16.5
Advances growth (%)	2.4	12.1	18.2	18.0	17.5

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
EPS	10.8	9.3	15.0	18.1	22.5
Dividend per share	0.0	1.0	1.3	1.8	2.3
Book value per share	121.0	130.2	146.6	162.9	183.1

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
P/E	11.5	13.5	8.3	6.9	5.5
P/BV	1.0	1.0	0.8	0.8	0.7
Dividend yield (%)	0.0	0.8	1.0	1.5	1.8

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Net interest income	3.3	3.2	3.5	3.5	3.4
Non-interest income	1.2	1.1	0.8	0.9	0.9
Operating expenses	2.2	2.4	2.8	2.7	2.6
Pre-provisioning profit	2.3	1.9	1.6	1.7	1.8
Provisions	1.1	1.0	0.3	0.4	0.4
PBT	1.2	0.9	1.3	1.3	1.4
Tax	0.3	0.2	0.3	0.3	0.4
ROA	0.9	0.7	1.0	1.0	1.0
Leverage (x)	10.9	10.8	11.3	11.9	12.5
ROE	9.4	7.4	10.8	11.7	13.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Net interest income	1.7	5.5	26.5	16.6	15.7
Pre-provisioning profit	19.3	(11.3)	(1.3)	21.7	26.2
EPS	(0.8)	(14.5)	61.7	20.9	24.7
Profitability & Return ratios (%)					
Net interest margin	3.5	3.4	3.8	3.7	3.7
Fees / Avg. assets	0.1	0.1	0.2	0.2	0.2
Cost-Income	48.5	56.0	63.0	62.0	59.0
ROE	9.4	7.4	10.8	11.7	13.0
ROA	0.9	0.7	1.0	1.0	1.0
Asset quality (%)					
GNPA	4.0	4.2	3.2	2.6	2.3
NNPA	2.3	2.0	1.0	0.9	0.9
Slippage ratio	2.7	6.8	5.8	3.6	3.6
Credit cost	1.7	1.5	0.5	0.5	0.6
Provision coverage	42.9	53.6	67.2	63.1	63.1
Ratios (%)					
Credit-Deposit	87.4	83.9	83.4	84.0	84.7
Investment-Deposit	28.3	26.1	30.5	29.5	28.5
CAR	19.7	18.9	17.6	16.4	15.9
Tier-1	15.5	15.8	15.2	14.3	13.8

Source: Company, BOBCAPS Research

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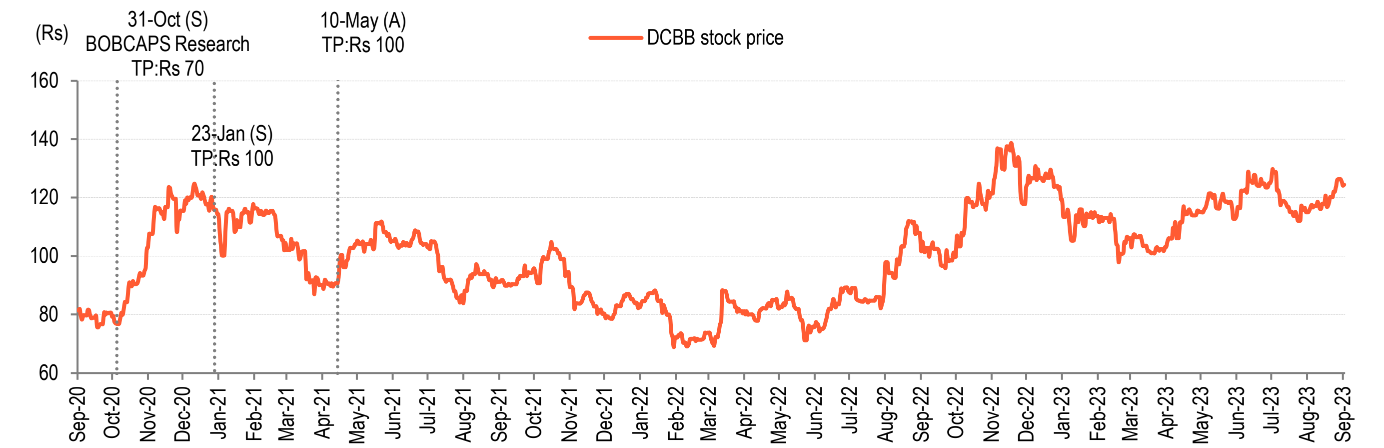
Registration granted by SEBI and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Recommendation scale: Recommendations and Absolute returns (%) over 12 months
BUY – Expected return >+15%
HOLD – Expected return from -6% to +15%
SELL – Expected return <-6%
Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): DCB BANK (DCBB IN)



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