“DCB Bank Limited Q1 FY19 Earning Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to DCB Bank Limited Q1 FY19 Earning Conference Call. Joining us on this call today are Mr. Murali M. Natrajan – M.D. and CEO, DCB Bank Limited and Mr. Bharat Sampat -- CFO, DCB Bank Limited. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Murali M. Natrajan. Thank you and over to you Mr. Natrajan.

Murali M. Natrajan: Good Evening, everyone. Thank you for logging into this call. So, I will just make a couple of opening comments and then we can get into the questions right away.

So first of all I want to say that in the result… I hope everyone got their presentation, I believe there was some technical glitch in terms of obtaining the 'Investor Presentation', but I hope everyone has got it. So point #1 is that last year we had in the first quarter one-off income of Rs.21 crores because of the one-time transfer of security, in comparison, this year is Rs.10 crores.

And second point is that while we can stagger the MTM hit over the fourth quarters, we have chosen to take the entire hit of Rs.2.6 crores in the first quarter itself.

Third point I want to say is that customers who have been impacted or who got issues in terms of the GST, etc., there is a circular of RBI which says that we should give more time to the customer and not recognize the same in our book as NPA. So we have chosen to give more time to customer and not affect their credit score or credit rating in CIBIL; however, in our book we have considered that as NPA and I have taken provision, that would be approximately Rs.30, 33 crores. The reason why I cannot give you the exact number is the circular says that the customers total outstanding across all banks should not be more than Rs.25 crores, but we believe that the customers that we deal with, should not have exposure of more than Rs.25 crores. We are pretty confident, yet we have chosen to recognize all of that in our financial book as NPA and keep the provision on that.

Fourth point I would like to say is that if you look at our restructured advances, it continues to be a pretty small amount; it is just about five, six accounts adding to Rs.31 crores.

The last point I want to say and then I link it at that is that in the NPA page in the presentation you would see SR redemption and our SRs which was approximately Rs.70 crores is down to Rs.50 crores and these are SRs largely representing our SME loans and mortgage loans. So we seem to consistently be able to recover from these SRs and that is applicable to our gross NPAs in mortgages and SME as well because it is a kind of representation of the similar portfolio. So when do have some slippages in mortgages, given that most of the customers have self-occupied property and these are small ticket loans, we have high degree of confidence in terms of recovery and we know that the loss given default is unlikely to be in any specific case. Unless we made a major mistake in valuation or legal, it is unlikely to be more than 30% in any loan, at least that is what our experience is. So those are some of the points I wanted to mention. I am happy to take the questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Ashwini Agarwal from Baroda Pioneer. Please go ahead.

Ashwani Agarwalla: Sir what is the reason for the decline in the yields on advances in this quarter basically Q&Q?

Murali M. Natrajan: Yield is a factor of market forces, the segments that we operate in are fairly competitive segment; mortgages, SME, commercial vehicle, all the business that we operate is very competitive. So, yield is basically reflecting the pressure that is there in the market in terms of getting these advances and fighting it out with the competition. The cost of funds (have) been slightly up because deposit rates have gone up and there is a time period between increase in cost of deposits and then you are passing on to the customer on this MCLR basis. Apart from that, the reason why our NIMs are slightly down from fourth quarter, is the combination of things which I will try to explain. In the first quarter of last year we had just taken Tier-I capital, so that benefits the NIM in that particular quarter on that base. If you see by end of fourth quarter, we have already got Rs.686 crores of Tier-II capital which was just about Rs.236 crores of capital Tier-II in first quarter of last year. So you are talking about more than Rs.450 crores increase in Tier-II capital which comes at 9.85%... of course it helps our capital adequacy ratio, but that has pushed up our overall cost of funds. Third point is that every quarter we have to meet the agri and weaker section and PSL commitment. It is very tough to meet the agriculture and weaker section commitment, so you end up buying some PTCs. Those PTCs are dictated by the market forces on what rate you get. So we probably did not get it at a rate that we expected it to happen, although we are making our own efforts to complete our PSL of agri and weaker section. On overall PSL, we are always excess, but we find ourselves short in agri and weaker section. So that also cause some challenge to our NIM. Last but not the least is the fact that we had to keep some excess liquidity instead of investing in long-term securities because the interest rate environment was so volatile that we did not want to end up taking a position where we are hit with MTM. Already we had an MTM of Rs.2.6 crores which we have recognized in the fourth quarter. So combination of these factors resulted in NIM coming down. Yield is one of the factors and two big businesses that are facing that is one is of course mortgages and the other is corporate banking, corporate banking is a very small part of our book.

Ashwani Agarwalla: So in that case, we should see more compression in NIMs going forward?

Murali M. Natrajan: It is difficult to say that, but what I would like to say is that I have always maintained for last several quarters that the business perhaps will stabilize at about 375 to 380 basis points, obviously we will try to do better than that, but that is where the kind of segments that we are operating in should happen. So, I am not sure that the NIMs will continue to fall, but it should get stabilized from here what I feel.

Ashwani Agarwalla: What was the reason for 70 basis points capital consumption in one quarter itself?

Bharat Sampat: 30 basis points impact is from ops risk jumping up in the first quarter, you know it is based on your last three years income. So that is not something which repeats, then it gets rest of the four quarters.

Ashwani Agarwalla: 40 basis points would be in the normal course of business?

Murali M. Natrajan: Yes.

Ashwani Agarwalla: So what is the minimum Tier-I which we are comfortable with, because if I see for the last six, seven years typically average money at 11.7%, 11.8% tier-I.

Murali M. Natrajan: It depends upon the ICAAP document that we do internally, we assess our capital, we look at our risk in various portfolios, we look at some stress test and all and we come to some conclusion on what is the level of capital that we are comfortable with. So I would say that anywhere from 10.25% to 10.75% is what our thinking is on Tier-I.

Moderator: Thank you. We take the next question from the line of Darpin Shah from HDFC Securities. Please go ahead.

Darpin Shah: So, sir just wanted to understand the NIM front only, you have been saying 375, 380 bps as the guidance, now we are almost there, and we have also increased the MCLR rates. So should we see NIMs bouncing back?

Murali M. Natrajan: It depends on the market forces on how the loan competition is. In first quarter and in last quarter of last year, we have seen some really crazy pricing. What we have started doing in the last 30-days or so, of course it will take some time is we are trying to refine our risk-base… we already have a risk-based pricing, so we are trying to refine it further so that we do not end up giving any price advantage to customer where we see more NPA risk, to put it simply. So that work is work-in progress. The second work that we are doing is that we are trying to see what is the level of excess liquidity we are comfortable with and what is the right way to deploy that liquidity without damaging your ALM bucket. So that is the other work that we are doing. So yes, there is a lot of work going on. Nobody wants to have a lower NIM, but yes, there is some work to be done there.

Darpin Shah: One data book-keeping question, how much book will be linked to MCLR for us?

Murali M. Natrajan: Corporate book is linked to MCLR, almost everything of course is linked to MCLR, but depends upon like whether it is a three-months or six-months kind of MCLR, most of our book would be in three-months MCLR bucket, commercial vehicle, tractors, etc., would be a fixed rate loan so that even if I increase MCLR it is unlikely to change, but rest of the book is all linked to MCLR.

Darpin Shah: We have been seeing that we want to reach 1% ROA by end of fourth quarter of FY'19. Would you like to share your vision beyond FY'19?

Murali M. Natrajan: Yes, the first thing is that we want to reach that vision, of course we have some vision even beyond that, but at an appropriate point we will share that also. Currently, the work that is happening is to try and ensure that branches breakeven. We used to have 500-odd ATMs before demonetization. If you look at our ATMs they kind of went down a bit and then came up again, probably went down by about 20, 30, ATMs or something and then came back again to a similar level. That is because we worked on trying to improve the profitability of each and every ATM, shutdown ATMs that are not making sense, etc., right. So currently the situation has become such that at least for the last two to three months we are seeing an improvement such that we are actually starting to make a positive contribution from ATMs. So from a huge negative ROE on ATM just by making profits on the ATM we have become huge positive ROE on that, because there is hardly any capital that is required from the income that you get on ATMs. There is no fixed cost, these are all operative ATMs that are sold through third-party, etc., So what I am trying to say is that each and every piece of our business we are like disaggregating and trying to make that look better such that the aggregate of all that leads to better ROA and better ROE. Similarly, we are doing the work on branches, similarly, we are doing the work on assets, similarly we are doing the work on fee income, like that.

Darpin Shah: But would you like to share any number beyond FY'19

Murali M. Natrajan: Beyond FY'19, at the moment, no. Once we get some guidance from the Board, we will definitely share.

Moderator: Thank you. We will take the next question from the line of Kunal Shah from Edelweiss Securities. Please go ahead.

Kunal Shah: A couple of questions from my side; first, in terms of CV growth, so we have been seeing a decent amount of traction in that, but this time around we have seen some increase in NPLs also, marginal but yes. Is there any pressure that you are seeing on operative cash flow or it is just a seasonality that you are seeing?

Murali M. Natrajan: CV portfolio have multiple things that happen there although we are only operating, we do not do strategic portfolio, we do small ticket FTU, FTB, used, all that is there, again, single-single kind of self-employed customer is what we do. What we found is that some confusion was there a few months ago on the new emission norms, there was some change that was happening whether AC will be provided in the cabin. So multiple things happen during any particular quarter or two quarters. I do not see any fundamental issues with the commercial vehicle portfolio, in fact, I would say that last quarter we perhaps may have almost recovered most of what slipped into NPA in commercial vehicles. So I do not see any major issues in portfolio and I think in the coming months we should see further improvement in the NPAs.

Kunal Shah: Sir, on corporate part, while it is low at this point in time, do we intend to build up capacity given that large amount of system is constrained on that?

Murali M. Natrajan: No-no, corporate banking we are very selective, even then we had one NPA in this quarter in corporate banking because that customer was taken to NCLT by other bank. I have no idea why they took the customer to NCLT because they are sitting on only fluid securities whereas we are sitting on actual real estate, so if the company is dissolved, we don’t stand to lose at all, but we are trying to liaison with other banks saying that we should allow the customer to operate even if it at a lower level of sales but anyway whatever has happened. So we are very selective on corporate, we do not intend to have a corporate book more than 15, 18% at any given situation and headcount of corporate has remained similar for the last at least four, five years.

Kunal Shah: Sir, given the target that we are giving for exit quarter March, improvement for our branches is very important, so how are we shaping up on productivity and how do we measure it?

Murali M. Natrajan: Productivity is an hourly activity for us. We have something called eDSR, eDSR is a mobile software, it is on their smartphone, every sales person, every frontline person is supposed to download that and that is mapped to their employee ID, so they have to input on what exactly they have done during the course of the day and sample call will be done to check whether they have actually done it. So, productivity is measured very-very minutely in our bank for all the frontline people, similarly for credit underwriters, we will be looking at productivity on how many files they process, how many calls they did for personal discussion, how many verification they did, etc., So there is a huge amount of work going on in terms of managing productivity at a specific resource level, more will be done of course, but I am just giving an example of what it is. We look at every branch that is not breakeven as per the time schedule and then we look at what should be done. Usually the issues are with the people, usually it is not with the location or the branch or something. You change the person, automatically you start getting some benefit. So work is on and we are moving towards improving this thing. If you look at our ROE, it is still at about 10.5%, we still have about 4% to improve and we are confident if we profitably grow this business, we should be able to achieve that.

Kunal Shah: As of now, the productivity among the branches is moving on expected lines?

Murali M. Natrajan: Yes, some of the branches are always a problem, even some branches which are doing well, suddenly in two, three months, they can slip also, so that is why I said it is a daily activity to be pursued by our supervisors.

Moderator: Thank you. We will take the next question from the line of Sagar Shah from KSA Securities. Please go ahead.

Sagar Shah: My first question sir was regarding your cost-to-income ratio actually. So in the last concall you had guided for FY'19 break your down cost-to-income ratio to maybe around 55 which is around 60 plus actually? On the branches front, can you throw some light?

Murali M. Natrajan: With regard to cost-to-income ratio of exit of 55%, we are still pursuing that, we will see one more quarter how that goes but at the moment we are still holding on to that thought. Regarding branches, I have already mentioned in my previous call, this year and next year we intend to add somewhere between 15, 18 branches. Once we finish adding 15, 18 branches this year and next year, we will see whether we need more branches or how many branches we need or what place we need. So we have not made any decision on that, but we have decided that for this year and next year we will have about 15, 18 branches per year.

Sagar Shah: My second question is as you have mentioned in your opening comments that due to the increase in the tier-2 capital, that is how you saw the cost of funds going up actually?

Murali M. Natrajan: It is part of the answer. NIM is a factor of number of moving parts. I tried to explain some three, four moving parts. One of the moving parts is the increase in tier-2 which comes at 9.85%, other moving part I mentioned is PTC that we took on agri which came at a pretty low rate, but there is no choice, we have to take that kind of call. Third, I mentioned is that in the first quarter of last year we had some tier-1 which gave us a little bit of benefit on our NIM for that particular quarter. Fourth, I said is that there was some excess liquidity that we maintain because the interest rates were volatile and we did not want to risk more MTM losses.

Sagar Shah: My question was regarding like three quarters, are we going to see some improvement in the bottom line as we see these one-offs coming off?

Murali M. Natrajan: We do not give any guidance on bottom line. We are able to give you guidance only on our growth intention for 3, 3.5-years. If you look at our balance sheet, Rs.10,400-

odd crores was our loan book in March 2015, we are double in three years and three months. Similarly, we are looking to double again in 3.5-years or so. So that is what we can tell you. Regarding the P&L and all, I leave it to your expertise to figure out what it will be.

Sagar Shah: My last question would be sir regarding the segmental part actually, you said that we are seeing some pressure in mortgage as well as the loan book. So do we intend to shift to some other segments also improving where there is less competition we see some good growth such as consumer finance?

Murali M. Natrajan: I do not think we are going to shift to any other this thing. Retail SME from whatever reports I read this year, we have been pursing retail SME for the last nine-odd years, it seems like for the next at least 10-years in India this will be the key area for us to focus on and we are in the right segment. Regarding products, the only product that we are missing perhaps is personal loans which we will do I think I mentioned even in the previous call which we will do little by little we will start to build that personal loan. Margin, yield, compression, this is all factor of all competition, I do not know of any situation where there is no competition, everything has some competition. So despite the competition, you just have to figure out how to kind of grow your book, not that there was very less competition three years ago.

Moderator: Thank you. We will take the next question from the line of MB Mahesh from Kotak Securities. Please go ahead.

MB Mahesh: A couple of questions; one, the exit ROE that you discussed for some time, do you still maintain to that number given that we have ended this quarter at 10% and directionally you still have some way to go to reach to that number? One, if you do reach, does this become at least in the near-term a sustainable number or do you expect some pull back on that specific number? Second, on the asset quality and the growth front, refinancing which was an issue in your portfolio for some time, what is the status of it? The third, the much discussed, it has been there in speculation in the media that you may have kind of looked at an opportunity in another bank. Your comments on the same?

Murali M. Natrajan: Once when I was working in Citibank, that was year 2001, my boss called me and said, can you give me the ROE, ROA for 2008? In about 10-seconds I gave the answer of 2008 ROE, ROA. He said, how do you know this quarter ROE? I said do not ask me about this quarter'sROE, ROA, but I am very sure about the ROE of 2008 is what I told him. He really appreciated that. So regarding your question on other bank, I really do not know where these rumors are coming from, it is very difficult for us to comment on the speculation, all I want to say is that we have a task here, I have a task here, we have set upon a journey, we are working as a team to get through this journey and we see that the journey that we have taken for retail SME which we have built over the last nine years and given the opportunities that are likely to open up in the next 10-years or so. I do not even know what is the reason, why this speculation. I am very happy working here and I continue to be very excited working in this bank. So those rumors I think you should disregard, that is #1.

MB Mahesh: Directionally, we just wanted to check whether refinancing in your portfolio has started to reduce and also if the clearing rates on your existing stock whenever you are trying to sell, has that…?

Murali M. Natrajan: Refinance you are talking about balance transfer? So that is a very important question that you asked. Balance transfer, as the interest rate start to move up, that is the deposit rate and cost of funds, balance transfer starts to kind of reduce. You will not believe, we see a direct link between interest rate increasing and NBFCs wanting to do either direct payment or PTC and all. Suddenly, there is a direct link between interest rate going up and PTC and other things coming in the market which is what we are seeing at least from the approaches of many NBFC. So I would imagine that the gap is narrowing, therefore there will be reduction in this. I think we are also getting better at protecting our portfolio which probably we were not too good just when this whole thing started, but I think over a period of time we got a good model to protect our portfolio. So I do think the balance transfer compared to what we have in the past should reduce, if that is the question that you asked. On ROE, it is a steep climb from 10.5% to 14% in three more quarters. We have lined up a number of initiatives. Obviously, it has got to do with how we get our branches to perform on fees, how we get our branches to perform on CASA and so on. So, I would not like to change that at least till the next quarter. We will see how the next quarter goes and give guidance if it will be required. At the moment, I just want to wait for our initiatives to come onstream.

MB Mahesh: Just a clarification, let us assume that you do reach to 14%, do we take as a base number also for next year or do you think it is just kind of just a short-term performance that you are going to see out there because investments has to go back into the business right?

Murali M. Natrajan: So we looked at some capital projection for like five years, eight years and so on and we felt that whenever we take some capital for one or two quarters, there is some challenge in terms of meeting that number, but then as our portfolio builds up, it kind of bounces back to even better than that. So at the moment, I would say that only when we take capital one or two quarters it seems like it will be a challenge for us to meet that number.

Moderator: Thank you. We will take the next question from the line of Amey Sathe from Tata Mutual Fund. Please go ahead.

Amey Sathe: Sir, one question on the MCLR. So we have taken around 25 bps increase in last say four months from February onwards. So is it fair to say that this number will start reflect in our loan yield say in…

Murali M. Natrajan: I think it is probably 16 bps. MCLR is calculation given by Reserve Bank of India, right, we just follow that calculation. Depending upon the specific contract that you have with the customer, you pass on that thing, for example if it is three months MCLR, every three months you will get the impact. So most of the re-priceable book I guess in three months MCLR. Some of the corporate loans have happened in one-month MCLR also. If there is a change in one-month MCLR, that can get passed on to corporate. So we can predict whatever on the NIM but I am not able to tell you exactly how the market forces would be on yield on advances. It would start getting reflected in the second quarter onwards for sure.

Moderator: Thank you. We will take the next question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal: My question is on the pricing trend in the corporate loan side. Given the major growth in some of the private sector banks in the segment, so how do you see the pricing compared to last quarter -- it has deteriorated, or it is stable or how it is that?

Murali M. Natrajan: Fourth quarter and much of first quarter was challenge but towards the end of the first quarter there was a lot more stability in price. For example, our cost of funds is 6.58 and if we offer say 8.5 to a corporate, so our spreads are only about 2% whereas Federal Bank shows the cost of funds of some 5.7 as an example I am saying if I remember right. So if they offer at 8.5, they are probably having more spreads. So, it depends on individual banks, cost of fund and profitability. For us it does not seem to make sense to propose risk point of view as well as from the spread point of view to pursue too much of corporate. That is why we have kept this business at a very small level.

Manish Ostwal: Secondly, sir, in the event of more pricing pressure in corporate segment, which is your #1 priority -- to maintain the growth or protect the margins?

Murali M. Natrajan: We are not in corporate at all. Suppose if corporate grows instead of 15%, 5%, we would not worry about it, we probably would just say let us pursue only profitable growth, do not worry about this thing. If you look at our growth year-on-year, 28% is the growth that we have achieved without corporate.

Manish Ostwal: Secondly sir, within the other buckets of our growth, mortgage and other categories, any pressure you are seeing in terms of pricing?

Murali M. Natrajan: Lot of pressure, there are pressure on pricing, there is pressure on giving more money to the customer, so customers say that he needs Rs.10 lakhs but our assessment seems to indicate that he should be given Rs.8 lakhs, there is some financier ready to give them Rs.10 lakhs, so you lose the loan. So every kind of pressure that you can think of is there in every loan. Probably gold loan is the only thing when I say pressure means not this kind of pressure, it is you have to go and make an effort to get. Other than that I think almost every business has got challenges on competition.

Manish Ostwal: The second point is when you say the 14% ROE, what are the two, three key risks not to achieve that number?

Murali M. Natrajan: If the trajectory of the branches that we have put together gets delayed for example, we have expected some branches to break even at a particular month and if it does not happen or it gets delayed, that would affect our 14%. If we for example, face more pressure than we are facing on NIM, that would affect this thing. We have some plans on how we want to grow our fee business if we do not achieve that, that would affect that. Last but not the least, we hope to keep our credit losses in the same range that we have been operating. For your information, floating provision is Rs.60-odd crores in our balance sheet as of now. So that is how well we have provided for our bad debt. So any of these factors if we do not perform to the level that we expect, can derail our ROE.

Moderator: Thank you. We will take the next question from the line of Rahul Maheshwari from TCG Asset Management. Please go ahead.

Rahul Maheshwari: Sir, in the current quarter the retail composition as a percentage of advances is just 4%, when I compare with YoY growth, it has come just 4% growth kind of thing as a composition in Q1 was 850 billion, I was looking at my own chart where. Can you give some factors which has led to …?

Murali M. Natrajan: You may want to look at our investor presentation on page #10 where we had given you different percentages, for example, retail, SME, all that put together is 65%, so 65% of Rs.21,000 crores versus 65% almost of the Rs.16,000 last quarter.

Rahul Maheshwari: I am looking just a particular retail excluding the SME part, excluding the CVs, construction finance and all this thing, pure retail banking which is there, which constitute 4% of your overall advances, why that has been softer growth as compared to earlier?

Murali M. Natrajan: You may want to separately discuss with Bharat and compare your numbers, I wish I could relate to your number, I am able to relate to the investor presentation only.

Rahul Maheshwari: Second part, can we expect the same kind of growth at least for SME and CV where you told is the main focus area for next 10-years would be there, such kind of growth rate to be maintained because on corporate, you told you would be more focused on the profitable growth rather than the volume growth?

Murali M. Natrajan: No, across we will see profitable growth, what is the point it is growing without making profit, all I am trying to say is that our asset book and deposit book could be skewed absolutely towards the self-employed SME, Retail kind of category and whatever investments we are making, we believe that our trajectory should help us to double our loan book in 3-3.5-years and in the past we have been able to do that, currently also the run rate seems to indicate that barring any unforeseen situation we should be able to achieve that, that is what I am saying.

Rahul Maheshwari: Your RWA growth would be lesser than the advance growth going forward?

Murali M. Natrajan: We definitely want to keep our RWA growth, less than our loan growth because when I look at mortgages, when I look at home loans and all, risk weight is much lower than I would say 75 or 73, some percentage like that, right, even SME does not have 100% thing. So that is one of the work in progress we have to do as to how do we make sure that we balance our book first and we do not consume too much capital, that work is still in process.

Rahul Maheshwari: Can we expect the mortgage as a percentage of your overall to stabilize at 40%?

Murali M. Natrajan: It should be 40%, at least the current trajectory seems to indicate that it should remain at 40%.

Rahul Maheshwari: But any long-term target where you want to take it?

Murali M. Natrajan: That is our long-term target that we keep it at 40%.

Moderator: Thank you. We take the next question from the line of Renish Bhuva from ICICI Securities. Please go ahead.

Renish Bhuva: Sir, couple of questions, one is on our employee cost, so though we have moderated our branch expansion couple of quarters back, but employee cost is still growing at 6% sequentially, so are we adding employees at the new branches, is that the reason?

Murali M. Natrajan: Every year we had employees and first quarter we had to give the usual increment both merit increment and inflation adjustment, so that would impact first quarter. The second point I want to make is that lot of our book is amortization loan book, like mortgages, amortization of loan, similarly commercial vehicles, so for growing the book at a particular clip, we have to constantly have some addition to our manpower, otherwise, we produce the same amount of sales if they not produce an increase in the balance sheet may just be enough to top up for the loss that we have because of the repayment, so there is a kind of a manpower planning that we keep doing, so every new branch will add at least six to eight kind of employees and existing branches when they are performing well and they demand more resources, we obviously give them because we have no hesitation in giving such resources.

Renish Bhuva: I mean historically we have been to know always on a higher side of employees per branch between 18 to 20 people, so that might have come down because we have added lot of branches in last two years, so is it fair to assume that even going forward your employee cost will continue to rise at least by 5% to 6% QOQ or it should moderate let us say after a year or so?

Murali M. Natrajan: What I want to tell you is that the employees that we add would be in line with our loan and deposit growth that we are expecting. Of course, the existing branches will be producing more and more, that is the expectation, so I would say that employee cost as well as operating cost should start to moderate in three or four quarters because we do not need that many more people to be added like the way we have added in the past. In fact, you can compare it in the last two years itself, actually it is coming down in terms of the number of employees that we are adding, so I do expect it to moderate, exactly in which quarter and how I cannot tell you in this call.

Renish Bhuva: No, Sir, let us say trend wise we should see some downward going forward that is what?

Murali M. Natrajan: In terms of not the number of employees, but in terms of the year-on-year cost.

Renish Bhuva: Sir, second question is might be repeated one, just can you please share the fixed-rate book versus MCLR-linked book, I mean you did mention…?

Murali M. Natrajan: We do not put that out, all I am saying is that you look at our book, commercial vehicle, part of tractors, and part of mortgages which are small ticket all that would be when I say fixed means it will be semi-fixed like they may be given a two-year kind of fixed-rate and then the MCLR will kick in, so there are various pricing depending upon the segments, so all I am saying is that when MCLR happens over a period of time, MCLR will impact almost every loan except that purely fixed loans.

Renish Bhuva: Okay, but you are saying that book would be a fairly small segment book?

Murali M. Natrajan: No, I did not say that, the fixed rate book would be part of commercial vehicle, part of mortgages, part of AIB, it is there in almost every segment. I will not call it segment, I will say product like tractor for example it is a fixed rate product.

Moderator: Thank you. We take the next question from the line of Krishnan ASV from SBICAP Securities. Please go ahead.

Krishnan ASV: Two things, number one generally given your core customer franchisees have been MSMEs and self-employed, I would assume the competitive intensity even though high, but generally you would be a primary banker or a sole banker, then where does all this competitive intensity stem from, if you could just give us qualitative flavor of…?

Murali M. Natrajan: There is no customer segment that is hidden from any bank or anything like that. There are NBFCs, there are HFCs, there are large fabulous banks like HDFC Bank, there are newer NBFCs coming. Almost four of my ex-colleagues from the foreign banks that I worked have started separate NBFCs and when I ask them what they are going to do, they are saying MSME and SME, so either people are going into consultancy or NBFC and starting to fund SME and MSME, so nobody can be hidden from and then there were plethora of DSA's everywhere who are expert in trying to do balance transfer and all, so even if I am the primary banker I do not see that unless and until there is lot of hook, like for example, we tried to do FX, we tried to do trade, but if your customer is a pure loan customer is that even if we are the only bank, if the rates at which we are giving is higher than the rate that which he is going to get, he will switch.

Krishnan ASV: Right, in which case what would then happen is most of your prime or Premier customer will anyways be available for other lenders?

Murali M. Natrajan: Just as other Premier and prime customers are available to us.

Krishnan ASV: Correct, and hence I just wanted to understand how well is your customer acquisition engine firing, you have invested…?

Murali M. Natrajan: If you want to know the data point for that, first of all look at all the pictures that I have put out for you, so that you know what customers we are getting and then you look at our balance sheet picture, it was 10,400 crores in March 2015, now it is 21,000 odd, without changing the product mix. We did not grow corporate or anything, we have just kept it at the same level, in fact the ticket size has actually become smaller if any in the last three-and-a-half years, so that is the power of our growth engine.

Krishnan ASV: What I am trying to get to is, Murali, our cost-to-income ratio has remained fairly sticky at about 58% to 60%, it is largely because we probably are spending a lot of time and effort and investing heavily in acquiring customers who then tend to be taken away by other lenders and yet you mention somewhere during the call that you have done enough, you have made enough efforts to strengthen that how you are protecting your customer franchise, so I just wanted to understand what have we done to protect our customer franchise better?

Murali M. Natrajan: Our cost has got to do with the branches that we put out, 150 odd branches that we put out in a very short time. The acquisition cost is very, very similar if not better for us as compared to what happens in the market. I am talking about the variable cost and the structure that we have for sales is similar if not better to what it is for even bigger banks like an HDFC Bank or ICICI or so on, so I do not see ourselves in any disadvantage in that position. The biggest asset class is mortgages, within that is LAP so what happens is when you have lot of these HFCs, NBFCs, Banks all wanting to do that product and especially when interest rates are declining, there is a tendency of customer to switch so that they will get a better pricing and just as some of the market people who could gain from our portfolio, our growth indicates that we have done a pretty decent job in growing our book as well, so our cost-to-income ratio would step-by-step come down as we build our business, as we improve our fee income. If you look at our fee income, core fee income has grown by 18% QOQ, which is a pretty decent and it is all very small granular fee income, so it is a competitive world and that is where we are operating, there are challenges I admit, but I do not see ourselves being in any disadvantage because of that.

Moderator: Thank you. We take the next question from the line of Aalok Shah from Centrum broking. Please go ahead.

Aalok Shah: Sir, just two questions from my side, at the start of the con call you talked about some 30-33 odd crores of SME portfolio, which was recognized as NPA by our Bank, where does this sit in our GNPA, I am just trying to look at our GNPA book on segment wise?

Murali M. Natrajan: Let me explain that, first of all it is not 30-33 crores hit in this particular quarter, so go through the RBI circular on the dispensation that they are giving to banks for customers registered under GSTN and not registered, but applying for GSTN, etc. Also look into the detail of NPA in August 2017, NPA in September 2017, October, and so on and so forth. Now, SME definition there is not the same as our SME book here. Even a customer who is a mortgage, loan against property customer who has taken loan for his business would be classified as SME. Similarly, if we have an SME customer sitting in AIB, he also would be considered as SME, even a commercial vehicle customer could be considered as SME based on the definition that is there, so over a period of time normal course of business we have taken some NPAs which are approximately 30-33 crores. We had an option to reverse it if we had wanted to, but we have not, we are giving more time to the customer, but we are saying that in our financial book, let this remain as NPA, we will not reverse it, let it be recovered and then we will reverse it.

Aalok Shah: Second is I missed out on the brief that Bharat had talked about on the capital consumption, so the reason for higher capital consumption?

Murali M. Natrajan: What happens in first quarter, the operational risk capital comes in which is 15% of your average income for the last three years, you simply have to add that it to your capital, so let us say last three years we have had 1000 crores type of revenue, 15% of that would attract capital, simple as that, so that every quarter you can see that in the previous year also for first quarter, you will see because we raised capital there, so you may not have seen it fully, but it happened there also in that quarter.

Aalok Shah: We have seen a good amount of upgradation this quarter of 40% upgradation being the best ever and also 40% of, what is going into this?

Murali M. Natrajan: Work is going on and we are pushing, working with customers, situation is improving in the market, part of the loan was gold loan, so that also got upgraded, see the way it works is if a customer goes to NPA this month, of course our intention is not to let him go into NPA, make sure that he keeps repaying; however, when it goes into NPA, it takes about six to eight months for the whole recovery process to buildup, we have to send him notice. We do not sell any property at all, very rarely we sell, but building pressure around him, getting him to understand how he needs to repay etc., it takes time, so this particular quarter and even the fourth quarter I think we did the pretty decent job of recoveries. Over a period of time and then do not say that I said this in one call and it has not happened, over a period of time our intention is that whatever slippages happens in mortgage, we should be able to upgrade that in that quarter, I mean equal to that we should be able to upgrade.

Aalok Shah: You talked about corporate portfolio which has taken to NPA by other members, do we have some of more such exposures which could probably fall in the NCLT cases?

Murali M. Natrajan: Whatever is the NCLT cases, we are dealing with that, touchwood, we are in a pretty decent position on each of those cases. not too many cases, and even in this case our exposure is very limited, I think it is 6 or 7 crores that is all the exposure is, so other banks have larger exposure and we are sitting on pretty decent property and I personally feel the customer is in very good business and if this whole process goes through, the business will do well. I personally think that he has good product and good business. There was some mismatch on his cash and so on because of which it became NPA, somewhere the bank felt that the right thing to do would be to take the customer to NCLT. We felt that better for customer to be given a chance to bring some capital without going into NCLT, but anyway the decision of larger banks prevailed and then we just moved on.

Aalok Shah: So more of such accounts where you think it could kind of turn delinquent and even if it is serving you well, we might have to take that as NPA?

Murali M. Natrajan: Yes, but it is all corporate book is usually unpredictable, at any point in time we have some two to three cases that gives us some trouble here there and all, which we keep if you see throughout the last seven to eight years, I have seen two to three cases are always in some challenge or something and they continue to behave well with us, some banks take some customer to NCLT and we have exposure, we will also get into trouble on that.

Moderator: Thank you. We take the next question from the line of Dhaval Gada from Sundaram Mutual Fund. Please go ahead.

Dhaval Gada: Sir, just couple of questions, one could you give a sense on how this portion of in-house sourcing has moved over the last couple of years and how do you expect that going forward, and the second question is just the employee count at the end of June?

Murali M. Natrajan: Employee count at the end of June is about approximately 6000. In-house sourcing almost 90% of our sourcing that happens in Agri and Inclusive Banking is in-house sourcing and about 70 odd percent of our mortgage sourcing is through DSAs. In all smaller locations that we operate, I do not recall having any DSA at all, it is all in-house sourcing, so I would say that steadily most of our SME is all in-house sourcing because that is all referred by the branches and so on. Construction finance is totally in-house, gold loan is totally in-house, so only mortgage has a large part of DSA, which is also steadily coming down, bit by bit it is coming down.

Dhaval Gada: What would this number of 70% maybe two years back?

Murali M. Natrajan: I do not have that number, but all I know is that, I do not know what would be the reason you are asking this question?

Dhaval Gada: Just trying to understand as the balance sheet is growing up, how is the internal origination in that line and is there any target that you have in your mind…?

Murali M. Natrajan: Each specific branch has a target, mortgage business much of the business comes from Metros and Metros are usually, if I may use the bad word infested with DSA's, so it is a problem but what happens is that as we improve our skill levels at the branches, the customer referrals continue to improve, I do not have that number but I do know that when I look at the cost paid to DSAs and all, it is not something away from what we are expecting to happen.

Dhaval Gada: Do you have a target in mind as to where you want to bring the 70%?

Murali M. Natrajan: We do not have any target on that, but it is all part of the same profitability and branch profitability kind of approach.

Moderator: Thank you. The last question is from the line of Sangam Iyer from Subhkam ventures. Please go ahead.

Sangam Iyer: Sir, just a clarification on what you explained to Aalok, the 30 odd crores that you said from MSME, it is already declared NPA that is there from the last quarter?

Murali M. Natrajan: It is part of the 400 crores NPA that we have, so let me clarify so that it does not confuse more, over a period of time that is from August to now July when GST came, we have been taking NPAs in the normal course of business when the customer does not pay in 90 days. When we talk about SME and MSME, we have divided our loan on the basis of product, commercial vehicle person is also SME, somebody who is doing business in rural area is also SME. MSME and SME business is also SME, mortgage and LAP business most of it is also SME. Even construction finance is SME, it is all definition of SME as given by the regulator, so over a period of time we have taken NPAs. RBI came with this thing saying that if a customer's overall exposure in the system is not more than 25 crores and meet certain criteria, you may not recognize that as NPA. However, we just let it be a NPA except that we are giving more time to customer and making sure that his credit record does not get spoiled.

Sangam Iyer: Sir, secondly you also mentioned that the competitive intensity barring gold loan to a certain extent has intensified significantly over the last few months etc., so given this kind of a backdrop and the fact that we are looking to retain our NIMs within a range of 3.85 or to 4 to certain extent, how should one look at the growth, would we be sacrificing certain growth still to maintain the profitability level at these levels or would it be the fact that the competition remains as is, it is going to be whoever is able to grab better market share even in the interim period if there is a slight margin dip that comes in, I mean would there be any trade-off that one would be looking at?

Murali M. Natrajan: Fortunately, unlike in NBFC, not exact compare, but we have worked to do on CASA as well, right, I mean I can improve cost of funds, so we have the other level which is CASA so you can see that savings account growth has been pretty decent for us if you compare with the last year first quarter, so the way to maintain your NIMs would be to keep working on cost of funds as well as trying to make some refinements in pricing within the acceptable regulation as to what kind of pricing regulation, obviously certain segments we can price it little bit higher, if we are thinking that it is slightly more risky than the other segment, so competition pressure is high and the same competitive pressure we have grown from wherever to wherever now, but I do think that the competitive intensity on this should ease a bit because interest rates have gone up and probably stabilizing at this level, so I do feel that it might stabilize in the next two to three quarters, so we will see, but we are quite okay with the current NIMs, I do not feel too bad about it.

Sangam Iyer: Sir, finally your views on the announcements that just came on over 25% incremental overloading being allowed for the freight operators etc., how do you, logically that has a direct impact on how the CV financing segment would incrementally work on, but do you see that it is going to have a larger impact in the near term given the way because 25% incremental overloading is kind of giving you a 25% hike freight increase to the operators?

Murali M. Natrajan: I have to read it more carefully because I have not had a chance to see, but it might actually improve the profitability of the carrier operators if they are allowed to load more, I mean that is my first reaction because it will get in more revenue for the same this thing, but their wear and tear will obviously increase, so I have no firm answer on that. Let me take a look at it and hope to come back to you on that.

Moderator: Thank you, Sir. I will hand the floor over to you for your closing comments.

Murali M. Natrajan: Thanks very much for attending this call and we will catch up in the next quarter. Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of DCB Bank Limited, we conclude today's conference. Thank you all for joining us and you may disconnect your lines now.