DCB Bank Ltd. Q2FY2015 Earnings Conference Call

November 03, 2014

Management Participants:

Mr. Murali M Natrajan – MD & CEO, DCB Bank Ltd.

Mr. Bharat Sampat – CFO, DCB Bank Ltd.

Mr. Sridhar Seshadri – Financial Controller, DCB Bank Ltd.

Mr. Gaurav Mehta – Head: Marketing, PR, Communications and Investor Relations, DCB Bank Ltd.

Ms. Meghana Rao – Head: Service Excellence, DCB Bank Ltd.

Moderator: Ladies and gentlemen, good evening and welcome to the DCB Bank Limited Q2 FY15 Earnings Conference Call. Joining on the call today are Mr. Murali M. Natrajan – MD & CEO of DCB Bank Limited and Mr. Bharat Sampat – CFO, DCB Bank Limited. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this 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, sir.

Murali M Natrajan: Thank you. Good evening all of you and thank you for logging into this call. I have with me - Bharat Sampat; Sridhar Seshadri; Meghana and Gaurav along with other staff members. I am a little pressed for time today, so I would like to wrap up this call by 4:45 - 4:50 pm. If we are not able to answer some of the questions, then we would be happy to take those questions on e-mail and respond back to you. So let me go in to the call and give you some highlights for the first few minutes and then I will open it for questions.

Firstly, I would like to apologize for the delay in declaration of our Q2 FY 2015 results. Ideally, we would have liked to do it by second week of October. However, since we were in the Capital raising process we were advised to have some kind of a cooling period before declaring the results and then of course we had difficulty finding dates from the Board of Directors.

I would like to straightaway start with the details on gross NPA and net NPA and then I will go on to the rest of it.

The gross NPA has increased from 1.78% to 1.90% and net NPA increased from 0.97% to 1.07%. Coverage ratio is at 77%. The fresh slippage for the quarter is Rs. 41.82 crore. There were two large accounts, one in Corporate that was about Rs. 12 crore and another in Agri and Inclusive Banking that was Rs. 7.5 crore. These two put together approximately Rs. 20 crore out of the Rs. 42 crore and the balance Rs. 22 crore comes from several small accounts which are usually in and out of NPA depending upon how they are servicing the interest or installments.

While the two accounts that I mentioned were under stress for some time, we were still hopeful of cooperation from the borrowers, however, that didn't happen and we were not convinced that these could be restructured because we were not happy with the proposals given by the customers. Therefore, these became NPA and we have taken appropriate provisions. We have hard collaterals in both these accounts, so we are hopeful of a resolution in the coming months. The balance slippages like I mentioned of about Rs. 20 odd crore is in Retail, SME and AIB and all are very small accounts. Again secured, there are no unsecured Advances and from month-to-month there are accounts that go in to NPA and then gets resolved in the following quarter or following month.

Recoveries and upgrades were Rs. 19 crore and write-off was Rs. 3 crore. We still have a couple of Corporate accounts to resolve for this particular year and barring those accounts rest of the portfolio in terms of SME, AIB, Retail is pretty much in good control. We do not expect any surprises in the coming two quarters. The restructured book is approximately Rs. 83 crore less than 1% of our book.

Let us now move on to Balance Sheet:

The Balance Sheet has grown by 4% since March 2014 and 21% as compared to September 2013. Advances have grown by 7%

since March 2014 and 32% since September 2013 that is the last year. Deposits have grown by 24% if you compare with last year and 4% approximately since March 2014. Customer Deposits excluding Inter Bank have grown by 9% since March 2014. We have been focusing a lot more on Customer Deposits and in fact we have consistently reduced some of the Inter Bank Deposits mostly coming from Co-operatives. We have tried to retain the small Co-operative Deposits and replace the larger Deposits with more Customer Deposits.

We are happy to say that just after the close of the quarter, we crossed Rs. 1,000 crore of deposits in NRI business. This is just a four year old business. We had just a few accounts and probably less than Rs. 100 crore of Deposits then and certain effort on getting NRI Deposits which has helped us to cross Rs. 1,000 crore. CASA growth since March 2014 is at 13% and 17% since September 2013.

SA growth for this half year is 9% and 20% since September 2013. I would say that we are still offering only 4%, we have not increased the SA interest rate and we are concentrating on self-employed individual and self-employed proprietors for building up our SA book. The CASA ratio stood at 25.5%.

Loan compositions pretty much the same as what we had in the previous quarter; mortgages at 42%, Corporate Banking at 24%, Agri Inclusive Banking at 13%, SME/MSME at 15% and others at 6%. Again barring loans to Microfinance Institutions and some few loans here and there bulk of our portfolio remains as secured. The outlook for the year, we are expecting Advances growth to be in the range of 25% to 27%. We are expecting Deposit growth to be in 24% to 26% and we expect the CD ratio to be below 80%.

NIM has been stable but there is a huge amount of pressure on customer loans. There is a keen competition in all segments and for us if the shorter tenure Deposits rates drop there will be a pressure on re-pricing of the loans and we are keen to take slightly longer Term Deposits because we need to make sure that we do not let the gap for Mortgage book get out of control. We have also received a demand for about Rs. 165 crore of RIDF/SIDBI bonds for not meeting the sub targets in PSL. Overall PSL we have met, but like many Banks we were also short of the sub targets. I believe that most banks have received such demands in the last few days. These bonds do come at a very low rate so that would impact in some ways the NIMs for the coming months. Of course again we are making all efforts to meet our sub targets this year but it is very difficult to meet 13.5% agri and 10% weaker section. However, we are confident of meeting the overall PSL targets.

Moving on to income:

The income growth for the quarter without one offs were at 25% as compared to same quarter last year. NIIs, Net Interest Income grew by 29% and non-interest income by 35%. Cost growth was 21%. Our estimate is that new branches and additional headcount is costing us about Rs. 11 crore for the half year of 2014. Since September 2013, we have gone up from 103 branches to 142 branches and the number of employees has increased from 2401 to 3184. So we have expanded quite a lot in the last 12 months compared to our base. We will continue to expand branches steadily. So far it seems that we are on track to achieve breakeven in 18 to 24 months on new branches.

Speaking about provisions - The total provisions for the quarter is Rs. 14 crore of which Rs. 3.5 crore is for Standard Assets and

Rs. 2 crore is for Floating Provisions and another Rs. 1.76 crore is for specific provision for Standard Assets. If you recall we made about Rs. 10 crore of provision for specific standard assets last quarter as well. So we again evaluated and have made Rs. 1.76 crore net increase in these provisions. So the provision for NPAs and restructured loans is about Rs. 7 crore, which is somewhat similar to either previous quarter or even previous year same quarter.

Without considering the new capital issuance which was closed on 10th October our Capital Adequacy was at 13.04% and Tier 1 at 12.16% this is under BASEL III. I believe we have sufficient capital to pursue growth for the next two to three years. Those were some of the highlights I wanted to share with you. I am happy to take questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Sandeep Jain from Sundaram Mutual Fund. Please go ahead.

Sandeep Jain: Sir, just wanted to understand when you have said on the asset quality that there are couple of accounts or more, can you quantify the same?

Murali M Natrajan: That is not public information that I can quantify. These accounts keep changing, so if I tell you some two accounts now then there may be two other accounts next month, so I am just saying that at any point in time we continue to work on two or three accounts especially in Corporate given the current economic situation.

Sandeep Jain: Sir, if I look at the capital consumption in this quarter; the capital consumption is quite high. What explain this from 12.77% if I look at to 12.16% what explain this?

Murali M Natrajan: You mean to say Capital consumption is higher, you mean to say we have used more capital?

Sandeep Jain: Yes.

Murali M Natrajan: Let us just look at our calculation I do not think it is that way.

Bharat Sampat: It is mainly out of loan growth. Our capital does not include year-to-date profits.

Sandeep Jain: No sir, I am talking about this sequentially. First quarter also you have not included the year-to-date profit, right?

Murali M Natrajan: Right.

Bharat Sampat: The Risk Weighted Assets have gone up to say Rs. 8,968 crore which is nearly Rs. 9,000 crore.

Sandeep Jain: No so sequentially your Advance growth is 6% so that explains the 4% sequentially growth on your RWA that is what you are saying?

Murali M Natrajan: Yes

Sandeep Jain: And the third final question is your HTM as a percentage of total Investment is increased say from the last two quarters from 73% to 81% and your SLR if I look at has reduced from 31% to 25%. So what explain this means we are adding more bonds there in HTM?

Murali M Natrajan: I think it is a good idea to use the excess SLR for giving loans, why carry excess SLR? So we can utilize our use of excess SLR. On HTM Bharat can make a comment.

Bharat Sampat: HTM increase is primarily due to reduction of excess SLR. We have run down our Investment book to an extent to fund the Advances if you see that and separately what is there in the book as AFS and HFT you will see the modified duration has gone up slightly because we have taken a little bit of position in bonds, Debentures and G-Secs. Earlier we used to park some of the liquidity in SLR in terms of Treasury Bills and short duration securities, which we have run down to an extent. If you see on the other side the Borrowings and Inter Bank CDs have also been run down.

Moderator: Thank you. The next question is from the line of Yash Mehta from Equirus Securities. Please go ahead.

Yash Mehta: Sir, first of all just wanted to know the taxes that we paid in this quarter those were lower then what we had expected so what is the guidance going ahead for the year?

Bharat Sampat: The effective tax rate for the year we have estimated in this quarter at around 15% and partly we have reviewed our book and reworked if there are any possibilities of write-off of accounts. So that has been factored in.

Yash Mehta: So for the half year now we should have an effective tax rate of 15%?

Murali M Natrajan: I think to be conservative, I would say that it will be somewhere between 15% to 17%.

Yash Mehta: And sir, is there any specific season, considering no major change asset mix, for the yields coming down?

Murali M Natrajan: Pressure is there on yields because the competition has increased a lot because I think loans are not easy to come by, for example in case of installment loans like Mortgages, regulators have removed the pre-payment penalty so the good part of it is that we are also able to get customers who has loans with other Financial Institutions or Banks. Similarly, we also come under some level of attack. Plus on Corporate we are trying to focus more and more on better rated companies, therefore the yields are not that good. There is a keen competition for achieving PSL in micro SMEs, so we keep getting requests from customers to review their interest rates. These are some of the factors, so there is pressure on yield. There is no change in mix, I mean there is no change of strategy. Except in Corporate we are concentrating on better rated companies.

Yash Mehta: And sir, so despite the QIP we would still maintain the guidance of margins at 3.3% to 3.4%?

Murali M Natrajan: Third and fourth quarter is always a challenge there is so much competition. See the problem with NIM and giving some guidance on NIM is there are so many moving parts in NIMs. From NPAs to RIDF to Capital raising to pressure on yield on Advances to repayment of some Borrowings. So I would say that I do not expect this NIM to improve. If there are factors positively impacting NIMs there are more factors I see that might actually impact the NIM negatively. I mean our intention is to keep the NIM at this stage, but I am just saying that there are lots of pressures.

Yash Mehta: And Sir, was there any sale to ARC during the quarter or half year?

Murali M Natrajan: No sale to ARCs.

Yash Mehta: And so the unhedged foreign currency exposure number?

Bharat Sampat: It is not a public number but we have provided for it adequately.

Moderator: Thank you. The next question is from the line of Manish Agarwalla from Phillip Capital. Please go ahead.

Manish Agarwalla: Sir, my question pertains to the cost-to-income ratio. If I just knock off the Interest on Income Tax so there is a constant rise in cost-to-income ratio in the last two quarters. So like we have been looking at some 60% number so and if you see the Operating Expenses have been growing at 20% plus. So just can you throw some light what is your take on that and how do you want to bring it down to 60% kind of level?

Murali M Natrajan: We have always given that we need about two year's time to bring the cost-to-income ratio to levels like 55%. That is because while we are growing Balance Sheet, we are also simultaneously investing in branches and headcount. You see our branches have gone up from 103 to 142. That pushes up two major costs which is the cost on premises & rent and people costs. We have taken the headcount from something like 2,300 to 3,100 which is what I said in my initial commentary. So we are expecting branches to breakeven in 18 to 24 months. Most of the branches that we have put up have come in the last one year.

In fact we will see last quarter of last year we have added a lot of branches. So these branches are on track. Recently we have done branch-by-branch kind of a review in our management team as well as some summary reviews with the Board to make sure that everyone understands that these investments have been yielding results and what is the time period that it will take for it to breakeven. If you look at it you should try and take off my one-off Interest Income and also back off the Rs. 11 crore that I have mentioned as potentially half year costs estimate for the new branches. Then look at the underlying cost-to-income ratio. I am confident the underlying cost-to-income ratio has improved.

Manish Agarwalla: My second question is in terms of your margins. If I look at the Yield on Advances that has come off on a sequential basis by 24 bps whereas Cost of Fund has come off by 6 bps but still our margins has now held up or remains the same?

Murali M Natrajan: There is more efficiency we had some excess SLR and all so there is more efficiency in terms of managing the liquidity.

Manish Agarwalla: So your CD ratio might, okay.

Murali M Natrajan: No, CD ratio is not. Supposing we are holding excess SLR and that is yielding much less than the Yield on Advances. So there has been a better management of liquidity and we are constantly looking at ways to take Customer Deposit and replace high cost

Borrowings. In fact first quarter we replaced a lot of high cost Borrowings with Customer Deposits. So I expect in the short tenure Deposits to be reducing whereas long term Deposit we have not seen any reduction in interest rate. In fact Inter Bank and CDs put together from March 2014 which was approximately Rs. 1,500 crore has come down to about Rs. 973 crore. So there is a better use of the liquidity that has helped us even though the yields have come down. And I do expect some pressure in NIMs in the coming months.

Manish Agarwalla: And these NIMs just for clarification are excluding this income tax refund, correct?

Murali M Natrajan: Always! we will never present you ratios with some one-off items and all. Always it is backed off. In fact you can see in our Investor Presentation they are also we have back off all those items. However, I have not backed off the Rs. 11 crore investment that is part of the cost base.

Moderator: Thank you. The next question is from the line of M B Mahesh from Kotak Securities. Please go ahead.

M B Mahesh: Couple of questions. One is see you have had now equity infusion of about Rs. 250 crore and that if you will work on a Cost of Funds basis you will get a benefit of about Rs. 20 crore to the P&L. Just trying to understand is not it good enough reason for you to relook at the entire Savings Rate at this particular point in time given the fact that you will get that benefit in the P&L as well? Just wanted to understand as to how are you looking at it. Second one is that what time do you think it is required for you to relook at the Savings interest rates itself? And the third question is on the LAP portfolio if you can broadly comment on your Mortgage book - how much is in LAP and how much is it in Housing Loans? And in LAP, if you can give some mix on how much is it for SME customers and how much of it is for Retail customers?

Murali M Natrajan: So first of all let us address the LAP issue right away. I can give you only an approximate amount which is there in LAP because sometimes Home Loans after four years or so can morph into a LAP. So I would say about 70% of our Mortgages book would be in LAP. And almost 90% of our customers I will call it as self-employed customers, very few salaried customers – less than 10%. And even if we do have salaried customers they may not necessarily be salaried in the top 5,000 companies and all. They would be salaried in smaller companies. And what was your final question on the LAP?

M B Mahesh: Just finishing this question itself are you worried that the gross NPLs has still holding at 1% because the book is growing also at a very, very fast pace?

Murali M Natrajan: We are looking at both lag indicator as well as leading indicators. So in terms of coincident delinquency and lag delinquency both are performing quite well in the portfolio. What we are also trying to isolate is sometimes when a customer is given say a program called top up; top up is when the customer has paid for about four years or so and then comes up for a top up. So if a Bank gives money to a customer then obviously he cannot be delinquent for at least two years because the Banks have given him money. So we are trying to isolate that portfolio also and check whether there is any stress or anything in the portfolio. At the moment at least our analysis of looking at those variables does not seem to indicate there is any stress.

So I do not see a problem with LAP portfolio plus like I said we are not going for big tickets. I have always mentioned that we are operating at below Rs. 3 crore. Very, very rarely we give any loan above Rs. 3 crore it is like a may be one loan a month or two loans a month that is very few and far in between. And also we are concentrating on smaller ticket sizes so our average ticket sizes would be say Rs. 40-50 lakhs is what I would say. In fact when we are moving to smaller towns it is becoming even smaller than that like may be even Rs. 20-25 lakhs that type of loans. So these are all SME customers, traders. They may be self-employed sole proprietor; there may be self-employed partner but essentially 90% of them are in this segment.

Now come to Savings Accounts. As a strategy and as an approach to our customers in fact we do not believe that we need to change the savings interest rates. We have approximately about Rs. 2,000 crore of savings and that would mean that if I change it by 2% it would be straightaway Rs. 40 crore cost for us – number one. Number two – if you change it, now I am talking from a marketing point of view, you will look like a me-too. So whereas somebody else has already talked about 6.5-7.0% and all these things we do not see any additional advantage of this. That is two. Three, when we look at our customer segment which is self-employed at Rs. 40,000, Rs. 50,000 average balance it seems to me that what we give them from a service point of view and any other additional products point of view seems to be working with them more than interest rates.

If they do have any other need for interest rate we offer them Term Deposits. So the answer to your question is just because we got capital we are not going to change the interest rates. However, unless big banks decide to change the interest rate, which I doubt, I do not see us making any change in that. However, we are looking at some alternate products to attract customers in the short end Deposits. Hopefully we will be able to close that product in the next three months but again it is just on planning stage it has not yet been completed.

Moderator: Thank you. The next question is from the line of Yash Mehta from Equirus Securities. Please go ahead.

Yash Mehta: This standard asset provisions excess that we had made last quarter the current slippages does any of that include the accounts which we provide for in that?

Murali M Natrajan: I am not sure. I do not have the information right now with me.

Yash Mehta: And sir, the branch lines that says 30 to 40 branches a year?

Murali M Natrajan: Yes, we are hoping to do about 30 to 35 branches every year. Like I said we are keeping one eye very, very firmly on the cost-to-income ratio and we want to make sure that the branches are actually performing; you see opening a branch, while it is difficult, it is a lot easier than making the branch work and produce results. So like a couple of branches we are not very happy. One is because we opened a branch and because of Telangana problem and all it is now almost 12 months not much has happened in that branch. So our focus would be not just on opening branches but also making sure that 18 to 24 months, we definitely get the breakeven on those branches. So 30 to 35 is what we are looking at. If we find that the investments are giving good results and our cost-to-income ratio is improving we might be encouraged to do more.

Yash Mehta: And sir, the tax refunds and any those have been received till now in this quarter or expected to be?

Murali M Natrajan: If we receive in this quarter we will report at the end of the quarter.

Yash Mehta: And sir, if you could just help me with the number again of restructured book and fresh additions?

Murali M Natrajan: Restructured book is about Rs. 83 crore. I think the fresh addition is about less than Rs. 10 crore in the restructured book.

Yash Mehta: And this would be how many accounts?

Murali M Natrajan: All put together five or six accounts.

Yash Mehta: And sir, what is the status on the communication with RBI regarding promoter holding right now?

Murali M Natrajan: It is an ongoing communication; there are continuous dialogues that we have and as of now we have raised capital and have made some movement towards 10%. So we are in the process of seeking more time to move towards 10% and we will see how that goes. So they have not written to us yet. If they do then definitely we will inform the investors.

Yash Mehta: So right now it says in March '14 that was the last date there?

Murali M Natrajan: Yes, there is no change in that March '14.

Moderator: Thank you. The next question is from the line of Prakhar Agarwal from Edelweiss Securities. Please go ahead.

Prakhar Agarwal: Just the number of branches that you are added over the past year is it there some sense on the geographical mix that you have added?

Murali M Natrajan: If you look at our Investor Presentation on Page #30 you will get a sense of where all we have the branches. Essentially our strategy is to add branches in Andhra Pradesh, Chhattisgarh, Odisha and Gujarat. We have added a couple of branches in Haryana, Madhya Pradesh is another area where we are looking at. Odisha, Rajasthan. We have added one or two branches in Tamil Nadu. Except for Jammu Kashmir and Northeast some of these states we are concentrating on our branches. We have also opened a couple of branches in Punjab.

Prakhar Agarwal: And sir, most of these are in Tier 2 and Tier 6 cities?

Murali M Natrajan: 50% to 55% of the branches would be in Tier 2 to Tier 6.

Prakhar Agarwal: And sir, just last questions. What is your ROA targets for couple of years down the line?

Murali M Natrajan: So next year would be a full tax year. So which means that assuming that we have a 13% or 14% ROE this year which means that full year next year I expect it to be about 10-10.25% because we would have a 33% reduction. From there on we have made a plan to get back to 14% ROE in 18 months. So that is where we are working on.

Prakhar Agarwal: And sir, what about ROAs?

Murali M Natrajan: Yes same. It will go from say 1.3% to say about 95 to 100 basis points. Again in 18 months time we want to take it back to the same level and it will come by growth, productivity of the cost that we have invested. That is what is the key

Moderator: Thank you. The next question is from the line of Sameer Bhise from IDFC Securities. Please go ahead.

Sameer Bhise: Just missed on the earlier part. Did you just say that Rs. 42.5 crore of say Corporate slippages from two accounts in this quarter?

Murali M Natrajan: No, so it is two accounts; one Corporate account and one Agri and Inclusive Banking account both put together is Rs. 20 crore. Upgrades and recoveries of about Rs. 19 crore; write-off is about Rs. 2.3 crore. The balance out of the Rs. 42 crore is several accounts in Gold loan, SME/MSME, and some small accounts in Retail etc., put together is about Rs. 22 crore of slippage.

Moderator: Thank you. The next question is from the line of Aalok Shah from Centrum Broking. Please go ahead.

Aalok Shah: Just one question. Could you put some color on the Loan growth, when we are talking about 25-26% Loan growth for this year and what we have seen is sort of a de-risking on the SME portfolio? So one, would that process of de-risking on the SME side continue and if that would it mean that the Loan growth for the second half would be more in nature of Corporate, Retail or SMEs would be something that would start to see a pick up?

Murali M Natrajan: So what is happening in the SME portfolio is that for the last two plus years we have been reducing large ticket SME loans, which I think I have mentioned in the previous calls as well. So for example a Rs. 7 crore account or an Rs. 8 crore account if we are not happy with the collateral as well as we are not happy with the level of exposure for that account we have been exiting those accounts. However, we are replacing them with smaller loans which are less than Rs. 3 crore. So the average ticket size on SME/MSME has dropped to I think even below Rs. 1 crore.

So there are two things that are happening in MSME/SME portfolios. Some of the large accounts have been exited. I think even in the last quarter, if I remember right one large account has been exited and we are filling up the SME/MSME book with smaller ticket size more loans with 100% collateral. That is why you would see that there is some stability there in that portfolio now. It had fallen from some Rs. 1,500 - Rs. 1,550 crore. Now I think more or less it is in the same range in the last two or three quarters. So I would say that that process will continue for the next six to nine months. So I do not expect SME/MSME to grow. Where the growth is likely to come is Mortgages, Agri Inclusive Banking and Corporate.

Aalok Shah: So in terms of GNPA when I look at SME, GNPA that is at 6.7% that would still take possibly four quarters now to see that it to reach to a considerable level?

Murali M Natrajan: While the GNPA is high there I do not get too worried about that because we have given all loans that are collateral based loans either we have the commercial property or the residential property or both of the customers. So it takes a little bit of time to negotiate with the customer go through the SARFAESI and then come to a settlement with that customer. So I do not expect that portfolio to be a loss. It takes time and we will recover.

Moderator: Thank you.

Murali M Natrajan: So if you are done then we can wrap up the call, ma'am.

Moderator: Sure, sir. There are no further questions in the queue. Would you like to add any closing comments?

Murali M Natrajan: Yes, I just want to say thank you and look forward to talking to all of them in the next quarter.

Moderator: Thank you very much members of the management. Ladies and gentlemen, on behalf of DCB Bank Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.