DCB BANK

Q2 FY17 Earnings Conference Call

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Moderator: Ladies and Gentlemen, Good Day and Welcome to DCB Bank Limited Q2 FY17 Earnings Conference Call. Joining us on the call today is Mr. Murali M. Natrajan – MD and CEO for 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 for an operator by entering '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to the Mr. Murali M. Natrajan. Thank you and over to you, sir.

Murali M. Natrajan: Good afternoon. Thank you for joining our Second Quarter Results Call. I hope everyone has got the Press Release and Investor Presentation, Investor Presentation has already been loaded on the BSE and NSE website and in a few moments, it will get uploaded in our DCB Bank website as well. Since tomorrow is Saturday and Monday I am travelling, we thought we will have the call right away after our Board meeting today. So, thanks for joining in. Without wasting any time I would straight away go into questions. Please ask your questions.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin with the question-and-answer session. We will take the first question from Prakash Kapadia from Anived Portfolio Management. Please proceed.

Prakash Kapadia: Sir, I had two or three questions. Over the last three years our corporate loan book has actually declined or been flattish, so is it yields are lower for the good corporates which typically would want to lend, when do we see this book growing?

Murali M. Natrajan: You would not see, we do not want to grow this book. We always said as a strategy that corporate loan book will at best grow at 15% - 20% and probably if you compare it with last year same time it is flat, maybe you compare it with last quarter it has gone up a bit. We are extremely cautious about corporate loan book. Given our small balance sheet we do not believe that it is a good idea to focus too much on corporate. And even in terms of our NPAs, if you look at our NPA book, one of the largest NPA at the moment that exists in Rs. 255 crores, is a Corporate NPA. So, our focus is Retail and SME and that is what we have maintained, Retail, SME, Agri Inclusive Banking, Small Ticket Lending, Secured Lending, varied portfolio. If you see our investor debt, you will find that we have a diversified portfolio, secured portfolio. So, Corporate loan book is unlikely to grow and even when we double our portfolio we are unlikely to see Corporate loan book being the lead, or even for that matter a major contributor.

Prakash Kapadia: Understood. Sir, on Agri and Inclusive Banking what was the outlook, given that monsoons are good, what are we seeing in terms of on the ground demand for tractor or farm equipment, across?

Murali M. Natrajan: Tractor demand is supposed to pick up and we are anticipating that. Commodity arrivals in all will start I believe in about a week or two weeks. So, we will understand what is happening on that. As such there seems to be some positivity around this monsoons, so we believe that it should be good. But actual numbers, how they will pan out are yet to be seen.

Prakash Kapadia: And lastly on Other Income, we have seen a jump of 27%, any one-offs in this quarter on a year-on-year basis?

Murali M. Natrajan: There are no one-offs in this quarter, last quarter we had a one-off i.e. the previous quarter, first quarter of this year. This quarter pretty much it is all granular income.

Prakash Kapadia: And anything specific which is driven or all the efforts in terms of newer…

Murali M. Natrajan: The efforts are on, the efforts are being made in FX, Insurance, cross sell, Mutual Fund, and we are seeing some success there. We are also seeing some success in our ATM fee because we have rolled out a lot of ATMs so we are seeing some success in our ATM fee pickup. Of course, processing fee is also strong because our loan growth has been strong. So, overall it has been a very granular kind of other income growth.

Prakash Kapadia: So, you would expect at least a 20% plus kind of growth rate in Other Income as well?

Murali M. Natrajan: We believe that, in fact we are targeting at about 16% growth. We want to see a few more months of performance before we can kind of give any higher guidance than that at the moment.

Moderator: Thank you. Our next question is from the line of Subhranshu Mishra from Anand Rathi. Please go ahead.

Subhranshu Mishra: There are a few questions I want to go through. One is, I see a small dip in our CASA proportion on a QoQ basis although your deposits have grown, and how do I read this?

Murali M. Natrajan: See, our focus is on; the most of the branches score card is focused on Deposits, CASA, loans, fees, etc. If you look at our year-on-year Savings Account growth we have grown 22% and we offer only 4% on savings. CASA growth year-on-year is about 18.6%. The CASA ratio would dip that is because the Balance Sheet is growing faster than our ability to grow our CASA book. We look at CASA as helping us to maintain our target NIMs, our target NIM is anywhere between 370 - 375 basis points is what our target is, we are doing better than that. So, I would not worry at the moment about CASA ratio, I do think that the CASA ratio will go down a bit before it picks up because new branches take time to build CASA. If you see the average CASA per branch, probably it has dropped from Rs. 20 crores to maybe Rs. 17 crores or so, that is because we have added so many branches. But once the branch gets established, about 6-8 months time the CASA seems to pickup. So, as long as we are able to have a mix of loans, portfolio and maintain our cost of funds I am not too worried about CASA. On a standalone basis, SA growth is at 22% which I think is quite okay.

Subhranshu Mishra: However, sir, if I just go back in history, on October 13th when you laid out the blueprint CASA was a significant leg of your growth plan.

Murali M. Natrajan: No, we said we will focus on CASA. We have always been guiding that CASA ratio will dip, you can go back to our notes, CASA ratio will dip and probably I even guided saying it might dip to 20% or maybe slightly below 20% before it bounces back. Target CASA growth is about 23% to 25% which we will reach when we find the branches becoming stable, because right now the branches are pretty new. In the last one year we have grown 68 braches, last year we said we will do 150 branches, 68 branches out of that we have already opened since October 2015. So, the branches take time to perform in CASA for us.

Subhranshu Mishra: And we are on track to get all the 150 branches before December 2016?

Murali M. Natrajan: I believe so, I think we have already done 68 which are just shy of 75, but we never said that it will be uniformly opened. We believe that we have ample time to open another, whatever, 75 - 80 branches. But more importantly, we always maintain that we find that the branches are not performing as per our target, we do not have any hesitation to slow down our branch rollout. But at the moment our success encourages us to rollout the branches as we planned.

Subhranshu Mishra: And any specific reason for this higher capital consumption in this quarter, I see almost 125 bps decline in your capital adequacy, on a quarter-on-quarter basis?

Murali M. Natrajan: The loan book growth is pretty strong, if you look at our loan book growth without considering Corporate it is 36% and with Corporate it is at 29%, the current year profits are not included in the calculation. That would happen only after the full year audit. We have approval from the Board to raise about Rs. 300 crores of Tier-II out of which Rs. 86 crores we have already issued in March, the balance Rs. 200-odd crores will be issued in the coming few months, so that will take care of our capital and then we will consider raising any pure Tier-I capital sometime in September 2017.

Subhranshu Mishra: My only thought here was, since you have not focused on the retail part, your RW inflation should not be as high even on a quarter-on-quarter basis because the risk rates are lower for the retail loans which is why that 125 bps of decline in capital adequacy was a bit of a concern.

Murali M. Natrajan: I do not think there should be any blip there because we are doing the same product that we are doing, there is no change, we have not gone into some major unsecured lending which will consume more capital. Just give us a few moments; I will just check what it is.

Murali M. Natrajan: I got it. So, what happens is from time to time we have some liquidity available with us because you cannot exactly time the deposit increase with loan book. So, we had some opportunities to put in PTCs, so those PTCs seem to have taken some capital but these are all short-term PTCs. Because see, instead of putting it in the call market or something, we get a little bit better pricing in a short-term PTC, we rather put that and improve our income.

Subhranshu Mishra: And one last question is regards to your higher NPAs and Mortgages, are we going higher proportion of LAPs here, what would be the proportion…

Murali M. Natrajan: We always did higher proportion of LAP, our loan book in Mortgages 65% to 70% is LAP, they are small ticket LAP. We go through every NPA to see what is the issue in NPA, we do not do big ticket, the maximum ticket size that we allow is Rs. 3 crores, very few loans cross Rs. 3 crores ticket size. As we increase our distribution and branches actually the ticket size on LAP and all is decreasing, it is probably hovering at about Rs. 40 lakhs or Rs. 45 lakhs, like that. So, if 60% - 70% of our mortgage book is LAP then it will so happen that even the NPAs will be coming from that category. This quarter we have had one loan where all of a sudden the customer seems to have gone into some property disputes with the entire tenant that they have had, so therefore it has turned out to be NPA. So, we analyze every NPA, we do not see any major issues in our portfolio at the moment.

Subhranshu Mishra: So if I read your thoughts correctly sir, the Mortgages NPA should likely remain elevated going forward as well?

Murali M. Natrajan: It will be in line with the increase in book, the way it happens is that when a Mortgage book becomes NPA it takes us anywhere between 8 to 12 months for us to build the recovery momentum on that, we are seeing much better recovery momentum in the last few months because you have to serve SARFAESI notice, you have to go through lawyer process, you have to negotiate with the customer, you have to do auction, all these things take time and then the customer comes for settlement. So, we are building that recovery pipeline, but as a portfolio when we look at vintage, when we look at time series, when we look at geography we do not see any major concerns in our portfolio.

Moderator: Thank you. Our next question is from the line of Kaitav Shah from SBICap Securities. Please go ahead.

Kaitav Shah: Sir just wanted to check with you on the capital consumption part. We have again consumed 120 basis points, so can you throw some light there?

Murali M. Natrajan: Yes. So, if you look at Advances growth, it has contributed to about Rs. 1,100 crores between the two quarters i.e. previous quarter to this quarter. And like I mentioned to the previous question that what happens is that we take a lot of Term Deposits and we create momentum in Deposits, it is not possible for us to deploy that immediately as the timing of the loan book, etc. So, we have invested in some PTCs where we get better yields than what call market or any other instrument gives, so that has also consumed capital, those are short-term which keeps running off. And as such we have plans to raise Tier-II capital of Rs. 220 crores more in the next few months. And so we should be, I mean, we have a plan for capital in any case, so we do not have any worries on that.

Kaitav Shah: So this would, according to you, not impact the longer term view on capital raising?

Murali M. Natrajan: No.

Kaitav Shah: And sir just one broad question, now on Mortgage as a market, I know for us, we are low in ticket size, etc, but given some concerns that even some of the credit rating agencies have highlighted, have you seen any such instances, has competition now pricing in LAP at a wrong rate, etc., what is your take?

Murali M. Natrajan: There are two major problems emerging in the Mortgage business, especially in the LAP market. Now, of course everyone will claim that they are doing the right thing and the others are the one who are doing the wrong thing, so I can tell you what we see. One is that there is a huge price competition between there is not enough asset switches so therefore everyone is chasing loan against property. Second thing is that because in order to take over a loan from another financier you end up overvaluing the property or giving more money than what the customer deserves. So, these two issues are coming up very-very actively in the market at the moment. So, how we are trying to protect ourselves from this is that we are going strictly by our credit policy, if we find that the customer is not eligible for the extra money or top-up we are just allowing that loan to be taken over by competition. So, we are seeing some uptick of what we call as the prepayment or prepayment attrition. Second thing is that as far as the pricing is concerned, we see from our own models whether the pricing that is being offered by the competition is something that we can match and still make money on that particular loan, if that is the case then we will end up offering and retaining the customer. As far as we are concerned, we try to avoid all loans above Rs. 3 crores, very few loans we do which are Rs. 3 crores and above. We try to concentrate on geographic spread and distribution to get a new customer as opposed to trying to play this game of going on taking loan from other financiers. What I have heard from a couple of NBFCs is that high ticket mortgage loan against property product is in trouble in some ways, delinquencies are higher, we are also looking at some troubles with credit rating agencies and finding that there is some stress in the market. But as far as our portfolio is concerned, we have looked at the lag indicator, lead indicator, geography, ticket size and so on; we do not see any concerns at the moment. It is a very active and sometimes it looks a little irrational and funny at the moment.

Moderator: Thank you. We have the next question from the line of Rajeshwar Rao from Perfect Research. Please go ahead.

Rajeshwar Rao: Sir, my question is, last time in the previous con-call you had said that main three NPAs from Chennai side due to course of cyclone action, so do we have any recovery actions right now?

Murali M. Natrajan: Yes, there was one, I remember some catering customer went into NPA, yes the action is on in that but we have still not recovered fully from that. There was one more I think, probably a dal trader or something who has also gone into NPA. So yes, I mean, no recovery has happened on those accounts but it will take time, I mean, when people get into financial difficulties it takes time for them to recover. But there are other customers with whom we have been working; those recoveries are coming through, of course. If you see there is upgrade and recovery of about Rs. 25 crores we have reported in this quarter.

Rajeshwar Rao: Sir, my next question is, actually you are acquiring more microfinance space, so due to the increasing competition and aggression in LAP and microfinance space how are you planning to mitigate this process?

Murali M. Natrajan: We are in Microfinance; we do Microfinance only to the extent what we need to do for meeting our priority sector lending, weaker agri target. We do Microfinance through three aspects, one, we give some direct loans to microfinance institutions for on-lending; two, we have some three or four BCs who do lending to Microfinance through BC; and three, we do some PTCs as and when possible. So, all this put together, I do not believe that our exposure would be more than maybe Rs. 600 crores - Rs. 650 crores or something like that. So, I do not think we are actually competing in the market; we are only competing as such that we need to fulfill our PSL requirement.

Rajeshwar Rao: And sir is there any plans for any acquisitions in future?

Murali M. Natrajan: No, we have no plans. Our approach is microfinance is useful for us to meet our PSL requirement, beyond that doing unsecured lending in such massive scale is not at the moment in our scheme of things.

Moderator: Thank you. We have the next question from the line of Kashyap Jhaveri from Capital 72 Advisors. Please go ahead.

Kashyap Jhaveri: Just taking the earlier question of risk weighted assets again, our risk weighted assets this quarter was roughly about Rs. 16,000 crores versus about Rs. 11,500 crores in Q2 of last year, that is about a growth of about 38%. Even if I were able to, let's say, total up investments which probably might include PTC and loan book, the growth in the total assets is not more than 30%. So, only PTC then cannot be the reason for the same, right?

Murali M. Natrajan: Growth in the loan book is about 29%.

Kashyap Jhaveri: Yes, let's say if I total up investments also into that, obviously which will include 0% risk weighted stuff also, but…

Murali M. Natrajan: I do not think investments are zero weight, PTC investments definitely not…

Kashyap Jhaveri: No, it would include G-Sec and SLR also, but total balance sheet growth even is not about 30%, so what explains that, is it there is a credit downgrade of some of the accounts…?

Murali M. Natrajan: We do not have, our corporate book is only Rs. 2,000 crores, and there is nothing to downgrade those loans. So we are not, I mean, like I mentioned before we are not into the downgrade. So, I mean, the corporate book is hardly anything for us to downgrade. So let me just see, investments have gone from last year to this year about Rs. 4,300 crores to Rs. 5,400 crores, about Rs. 1,100 crores they have gone up in a quarter and we have loan which have gone up by about Rs. 1,100 crores in one quarter.

Management: Even operation risk to date.

Murali M. Natrajan: That is the other one, but that would have got reflected in our, yes. So, operation risk also has come in which is function of the full year income of the previous year. So that also accounts because we have to take the average of last three year income, so that also has been factored in. Anyway, we will analyze it and come back to you specifically if there is any issue in this.

Kashyap Jhaveri: Second question is on the cost side, we have opened about 68 branches since you have announced the plan of branch expansion, but the costs have not risen commensurate with that, I mean, they have grown but not as much as what…

Murali M. Natrajan: It will come, I mean, the cost builds up slowly only, there is no escaping cost. So, when you put a branch for example, some five people will be hired immediately as we open the branch, then some three-four more people will get added to that. If you have paid for two months of, let's say we got two months' rent free as we were in the construction phase the rent will start building up. So, I do not think we can escape the cost, it will all come. So, I do not think, I mean, I am not even looking forward to escaping this cost, that will be there, you have to work on making sure that they produce income for us. If you look at our cost quarter-on-quarter for last year to this year, last year Q2 FY16 our cost is Rs. 120 crores which has gone up to Rs. 151 crores, Rs. 31 crores it has gone up. So, that is a pretty steep increase already, on 68 branches if you take even about Rs. 60 lakhs - Rs. 65 lakhs per branch it is already like Rs. 36 crores odd. So, I think cost will come in line with our increase, there may be a timing difference here and there but it will come.

Kashyap Jhaveri: And third question is on your Wholesale Deposits, our CASA has grown from about Rs. 3,200 crores to about Rs. 3,800 crores, Retail Deposits including NRI are from about

Rs. 18,000 crores to Rs. 19,000 crores. So, if I work on the balance number which could be wholesale TD, that number seems to have gone up from about Rs. 2,200 crores to almost about Rs. 4,000 crores. So is there any…?

Murali M. Natrajan: As per our estimates 77% of our Deposit will be Retail segment, our stated strategy is that 30% will be Wholesale and 70% will be Retail, that is what we have always said for the last seven years and we have always maintained it, sometimes it goes to 80%, sometimes it goes to 77%, like that. So, the focus is on getting Retail Deposit which is currently running at 77% that includes CASA as well.

Kashyap Jhaveri: So this could be sort of one-off for the quarter?

Murali M. Natrajan: Yes, I mean like you cannot time some of the Deposits. Also, what is happening is as our rating improves and our balance sheet becomes bigger, there is a lot of long-term funding that is becoming available to us whether it be from NHB, SIDBI and so on. So, we do not want to let go of that opportunity because that also helps us to plug the gap in our mortgage book mismatch in terms of the tenure. Plus, if you look at it, I mean, if you have the presentation, on page six of the presentation I want to point out a couple of things. So, page six you look at column March 2013, look at borrowings, Rs. 1,525 crores of borrowing is there on Rs. 6,500 crores of loan books, that is in FY 2013. Now fast forward September 2016, Rs. 1,230 crores borrowing on a Rs. 14,400 crores Net Advances. So, we are funding with Retail Deposits, we do not rely too much on borrowings and stuff like that.

The other thing that I want to point out to you guys, just so that, this question has not been asked but it is my job to point it out. If you all go to page number four, page number four, just to show you how confident we are about our strategy, although there may be like a blip here and there within a quarter here or there, look at long-term. FY2012 we had 84 branches, Balance Sheet Rs. 8,700 crores, cost to income ratio of 74%, ROA 0.68%, ROE 8.38%, no tax was being paid at that particular year, there was no income tax. Fast forward Q2 FY2017, 228 branches which is equal to almost three times the number of branches, Rs. 22,000 crores of Balance Sheet, cost income ratio dropped from 74% to 59.96%, return on asset 0.94%, and return on equity 10.41% at full tax rate. So, I think there is a strong business case which we can see for sure.

Moderator: Thank you. We have the next question from the line of Ankit Choudhary from Equirus Securities. Please go ahead.

Ankit Choudhary: So, one question is regarding the LAP book, so if you could throw some light on how much of balance transfer you have seen happening from your book and if that is a problem?

Murali M. Natrajan: Yes, balance transfer is a problem because there is aggressive repricing plus top-up being offered by many competitors. We are trying to be extremely sensible about it and we have taken a step back to say that if there is irrational pricing combined with crazy top-up, it is better to let the loan go rather than try and retain the customer. The other problem that has happened is, since RBI removed the prepayment penalty it has benefitted direct sales agencies quite a lot because they keep transferring the loan from one to the other and making a lot of commission income on this. So, it is a problem in the market and so what we are doing is, we are saying that since the problem is quite acute in a big ticket loan, try to focus on small ticket and distribution, avoid big ticket, avoid any loan that seems to not fit in to our credit criteria. So that is how we have been dealing with it, but yes the problem is still there.

Ankit Choudhary: And would you be able to throw any light on the numbers there, I mean, what percentage of the book gets transferred in a quarter or so?

Murali M. Natrajan: Those are not published numbers and it changes from month-to-month because we also have a separate unit which kind of does analytics to see who are the customers who are likely to switch from our book to somebody else's book or something like that. Of course, numbers have increased a lot from last year, but in the last two-three months because of the analytics action that we have taken it has also kind of brought under control. Other than that I am not able to offer you any more numbers on that.

Ankit Choudhary: And sir one more thing, so when it is the other way round so what is your policy on refinancing some another one of your competitors, I mean, one of the customers from your competitors?

Murali M. Natrajan: No, we go by strictly by our credit criteria. If we either get a loan lead from either a DSA or from a branch or anybody for a loan, we just apply our criteria, if it fits the criteria we give. Many times when we offer the loan to the customer the customer may not take it because he finds that the existing bank or NBFC may offer higher amount. So in that case we just lose that lead, so that is a very normal process that happens. All we are saying is that we have defined our credit criteria, we are saying that let's be disciplined about it and stick to that. Work on productivity, work on distribution, work on more geographical reach because we are opening so many branches we can do loan in many locations. The competition has become extremely keen in loan against property; there is no doubt about it.

Ankit Choudhary: So one last question regarding the movement in gross NPAs, so I can see a significant increase in upgrades in this quarter compared to the previous quarter. So, I mean, how granular was this or are there specific large accounts?

Murali M. Natrajan: If I do not have, you look at our corporate NPA book, do you see any movements there, that means there has not been big recovery. Even in the corporate NPA book of some Rs. 86 crores there are three or may be four corporates combined makes it Rs. 86 crores. So, those take time that is why we do not like corporate, when it becomes NPA also a problem, recovery also a problem. So, all our recoveries are granular recoveries.

Moderator: Thank you. We have the next question from the line of Jahnvi Goradia from Motilal Oswal Securities. Please go ahead.

Jahnvi Goradia: Sir, my question is not particularly related to this quarter, just wanted to understand same case of retail mortgage loan. If a loan goes bad, say a Rs. 100 loan, what is the typical cost involved in recovery of that loan?

Murali M. Natrajan: So, we have an in-house team plus few in-house lawyers, when I say few means like maybe six or seven in-house lawyers at various locations. So, what happens is a loan does not go bad one day suddenly, the customer first gets into some repayment problem, and very few loans become NPA all of a sudden. So, a customer will first not pay one installment, and then sometimes he will continue to be in one installment arrears, then not be able to pay two installments, so like that slowly account deteriorates. So we have a collection process where different set of in-house collection people meet the customer or talk to the customer on the phone to try and find some solution to this loan. So, the cost of these people are in the range of anywhere between, depending on the seniority of the collector could be anywhere between Rs.3.5 lakhs to Rs. 4 lakhs per annum to even Rs. 7 lakhs to Rs. 8 lakhs per annum, depends on seniority, skill level, etc. If after that if it goes to NPA, then our in-house lawyers will serve the notice to the customer, go through the court proceedings and all, we do not use any external agencies therefore all our cost of collection is all based into our P&L. So it is not a variable model on which we are working, it is all like our own in-house collection. So I do not have a specific exactly for one customer what the cost is, it depends, some customers will work in just one or two notices, some might even take a lot more effort to recover.

Jahnvi Goradia: And sir just one more question that is on MFI, as you know you mentioned before that the MFI loans that you do that is mainly from the point of view of meeting PSL requirement, so just wanted to understand your rationale in getting a stake in the Annapurna MFI, I think 6%?

Murali M. Natrajan: Annapurna, we have been working with Annapurna which is a very good company, I have personally met the promoter at least three or four times. We like their business model, we like their approach towards credit, we like their team, we have done a lot of due diligence and since we knew them for so long and we appointed them as BC we thought we could show our seriousness of working with that entity long-term by investing. So, other than this small investment there is no great long-term plan in this, it's just that by being an investor it gives us a lot better leverage with that entity, that is all.

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

MB Mahesh: Just two-three questions. One, what was the total employee base at the end of the current financial quarter?

Murali M. Natrajan: Approximately 4,700.

MB Mahesh: Second question is in continuation of the previous one, what do you think of the trend on, how long does it take for you to resolve NPLs in the mortgage side as compared to what it was last year? And do you have had to take haircuts today or it is achieving a much higher than the face value of the loan or a settlement seems to be a best solution as compared to going through a legal process?

Murali M. Natrajan: They are very rarely, but yes there are cases where customer will come and actually hand over the property and say that please auction it and then we will settle. In other cases which is also a few where customer will actually give you a timeline to say I will sell the property and settle your loan, that happens. And we encourage that because if a customer sells a property it will always sell at a better price. Well, if bank sells a property it does not get you as good a price as when customer sells a property.

MB Mahesh: No, the reason I am asking is that, is it fine to understand whether banks have had to now start looking at losses in the mortgages portfolio when delinquency occurs?

Murali M. Natrajan: Yes, my answer to that is, if your LTD is about say 75% or the customer has paid you three, four years of installment where his equity is very much in the property, very rarely you take a haircut of the principal. You may take a little bit of haircut on your accumulated interest or penal charges or something like that, but very rarely you take a haircut. In fact, what we do is when we find that whenever a customer gets into some delinquency we revalue the property, the reason we revalue the property is while we have very good process of valuing the property before giving the loan we believe sometimes customer becomes delinquent because maybe he thinks that the property prices have come down or maybe his equity has reduced. So we just out of caution we revalue the property. When we revalue the property and find that we have adequate coverage, hardly ever we agree on a haircut with the customer. But larger property, supposing you talk about a Rs. 5 crores - Rs. 4 crores property or there is some kind of a dispute that has happened with some tenant or something like that, you can end up even taking a haircut of even 15%/ 20%/ 25% like that. So, high ticket loans I believe there will be haircut. Small ticket self-occupied property; very rarely I have seen any haircut on the loan.

MB Mahesh: Sir, time taken to resolve loans is getting lot difficult that is why.

Murali M. Natrajan: Smaller loans faster, larger loans take for a long time; it can even take two years for larger loans to get resolved. I guess it all depends on the customer, there are lots of customers who get into genuine difficulty, he is trying to sell his property and at the same time run his business as well. So, that is where he needs some time and we believe in working with the customer rather than trying to push him over the edge because that does not solve anything because he can just simply take a couple of stay and just make us run around forever.

Moderator: Thank you. We have the next question from the line of Dhaval Gada from Birla Sunlife Asset Management. Please go ahead.

Dhaval Gada: Sir, a couple of questions for a little longer term, how has your experience been under the MCLR regime? We had some issue, means, and our thoughts on net interest margins because we were expecting the margins to settle lower because of MCLR regime starting post March 2016, but we have not seen such impact on numbers on net interest margin. So, should one assume or think about…

Murali M. Natrajan: Never assume better margin, that is a very incorrect way to make any projections. If you look at our margin I think it has gone down from 4.05% to 3.96% and if you look at our yield, yield or advances has come down from 12.5% to 12.01% in a matter of just six months. So, of course we are finding some benefit in cost of fund as well, the key challenge in MCLR is as soon as you change your deposit rate you have to reflect that in MCLR which means you may not have received even one deposit on that particular rate, you would have to change the rate. Are you with me?

Dhaval Gada: Yes sir, but our guidance last year or maybe our thought process, means…

Murali M. Natrajan: My guidance on NIM is always conservative; I do not believe that it is easy to maintain NIMs in this kind of market. And I still maintain that we want to assume 370 basis points as our model, if we do better than that we are quite happy with that of course, but MCLR is a process whereby you have to pass on the benefit of the customer as soon as we change the rate. And we are in a situation where there are lot of moving parts, deposit rates are changing, CD rates are changing, so it is not possible for us to say what exactly, a lot of items have gone through. But I am saying that I want to be very conservative and say I do not want to guide more than 370 - 375 basis points as foreseeable margin for us.

Dhaval Gada: Sir on your asset mix, if one has to assume next two to three years' time and a lot of emphasis on self-employed customer base and low ticket size loans, but what are the few products you still feel that there is gap which we are missing and other banks have, maybe other than the credit card which are the products which would be there which could become big in times to come for us? And the second is, what do you see for the segments like gold loan, personal loan, auto loan and maybe CVs as well, means, overall vehicle finance book and all, would we see higher growth in such segments in times to come?

Murali M. Natrajan: So, from the approach of branch banking we have a concept of all products all branches. Now while that is the approach, it takes time to train the front line staff to be able to sell like two or three products to customers, it is not easy because these people have paid like Rs. 3 lakhs - Rs. 3.5 lakhs, it takes time for us to train them, make them understand how to sell the product, how to fulfill the customer needs, etc. We don't think other than personal loan and credit card we are missing any important products in the retail segment, personal loan to our own customer we plan to offer in a limited way in the coming months but it will still be not more than 4% to 5% of our total portfolio, we are unlikely to be a big player in personal loan. As far as gold loan is concerned, gold loan is a mandatory product for all branches because we believe that it helps to acquire customers because I do not know of any small ticket customer who does not need a gold loan, I mean, self-employed, salaried, everybody requires some gold loan. So, our approach is trying and equip the branches to sell all the products, so we are selling gold loans, we are selling SME, MSME, we are selling mortgages and wherever possible in the correct catchment area we are also selling commercial vehicle and all, of course we have a separate team for commercial vehicles who sell across many locations. So that is the way we are approaching it, I do not see there is any product suite missing as far as we know.

Dhaval Gada: But most of these product segments, means, if you look at Slide #12 on NPAs distribution, so there has been reasonably higher increase maybe in terms of percentage wise when you look at say CV NPA number, maybe gold last year second quarter had higher number but other than that the run rate number was pretty lower than what it is now.

Murali M. Natrajan: Dhaval, I want to tell you that I do not worry about, I mean, maybe you guys worry about it but I do not worry about any small ticket secured lending NPA unless while booking a loan there is some fraud or something like that where the loan itself is in question. Customers go into delinquency, it is not a perfect world, customers go into delinquency, come out of delinquency, guys get upgraded. So our focus is on small ticket, maybe quarter-to-quarter there is some blip of some delinquency here and there all, as portfolio we look at lot of analytics, we are confident that the portfolio quality is quite okay compared to the kind of segment that we are talking about. The only thing that we always worry about is corporate loan, if you ask me I worry about corporate loans because I always tell you some two, three loans, keep giving us trouble, also these loans have been with us for six, seven years and all, they giving us trouble. So I do not worry, just because some three accounts went into NPA I do not worry about that because it comes back.

Dhaval Gada: Sir last question if you permit, see last year you had also mentioned about maybe competition from SFBs, if I have to understand where if at all we have seen any sort of competition which is significant enough and what would be the difference say of your lending rates to your customer base then maybe of these SFBs or any near competition? Means, what would lead you to maintain your lending rates or what would be the key triggers?

Murali M. Natrajan: I think SFBs may take a while to reduce their cost of funds for them to be able to lend at the rates that we are lending which is at average of about say 12% or so, some are at 10.5% and some are slightly higher, so I think that will take time. We have faced a lot of competition from Bandhan and IDFC on deposits for sure, not as much in CASA as in term deposit because term deposit also is a very important thing; if there is a lot of competition there our margin can get squeezed from that. So, we believe that the segment that we see are operating which is the small ticket size like 40 lakhs, 50 lakhs and all, there is enough competition but not that that we cannot handle that competition. As far as the small banks are concerned, we have not yet seen too much of action on the ground, maybe it will happen in about few months or so, maybe they are getting their act together, I do not know, we have not seen any action but we are quite prepared for it. And that is one of the reasons why we put all these branches, I explained to you guys, so we have 68 branches better than what we were last year to tackle the competition.

Moderator: Thank you. We have the next question from the line of Vibha Batra from Fair Connect. Please go ahead.

Vibha Batra: I have a couple of questions. First one is that what kind of Tier-I capital would you like to maintain? We have seen it dropping to 10.76%, it's definitely above the regulatory norms but considering your business mix what is your comfort level? Second question is that what is the yield on incremental advances, presentation says 12% and assuming it is a weighted average mix, on an incremental basis what would it be?

Murali M. Natrajan: So, obviously the incremental basis is coming at a lower rate that is why the overall rate has dropped from 12.5% to 12.01%. And in SME and all, even existing customers when they come up for renewal there is a process of rate increase, decrease, etc. So, we do not present what is our incremental advance rate, this is a rate at which we are operating at the moment. As far as the Tier-I capital is concerned, we believe that we should be at about 10.5% - 10.6% at a minimum, the current year profits are not included in this calculation. And I think that there are also options available of alternate Tier-I which we call Additional Tier-I which we will explore, but we are quite comfortable for capital till at least I would say September 2017.

Vibha Batra: And your ROE is at 10.4%, so given the current context whereby NIMs are going to be under pressure and the capitalization maybe you will get some benefit if you drop from 11% to 10.5% what is other thing that could push that or pinch in current level.

Murali M. Natrajan: So, we have given guidance on ROE, ROA on October 30th, 2015 on what is likely to be our cost income ratio and what is likely to be our ROE in the fourth quarter of 2019. I believe we are working towards that. As far as the biggest benefit we are likely to get on ROE we believe is going to be our improvement in cost income ratio consistently which is based on productivity of the branches and growth of our balance sheet, that is what would be the biggest contributors and that of course assume that we will not mess up on credit cost. If you see our credit cost, the actual NPA provision that we have made between last year the same quarter versus this year is exactly the same but the book has grown by 29%. And we also have what you call as the floating provision which is a discretionary provision that has allowed the RBI for management to create. We have some 32 crores or 33 crores of floating provision which we have not utilized for anything at all. So I think we are quite comfortable, the best improvement will come in cost income ratio which will straight away depend on cost productivity, branch productivity and increase in our balance sheet. And that is aptly demonstrated by slide number four, please see slide number four you will understand that what we are saying is quite well demonstrated.

Moderator: Thank you. We have the next question from the line of Aalok Shah from Centrum Broking.

Aalok Shah: Just one small question, you talked of an employee base of 4,700, when I look at that in terms of employees to total number of branches that work out to 20.6 versus 23. So incrementally is that what we are looking at in terms of employees per branch or…

Murali M. Natrajan: No, per branch employee count currently is higher that is because we also have separate teams in mortgages, separate teams in SME, separate teams in commercial vehicles, separate deposit teams which are not necessarily attached to any branch. As we increase the number of branches the separate teams are not growing as fast as the branch staff is growing, so therefore on an average I would think that the branch staff should come down. But having said that what happens is that a lot of existing branches which are performing so well they ask for additional people because they believe that there is more opportunity. So, it is always a challenge to not allow them this thing, give them more opportunity to increase their balance sheet. So, I would say that yes, I mean, I do not look at that average number per branch, I look at more like what is the employee productivity. So when we compare this even with Citi Union Bank and all, while they show something here and there and all but we look at is their employee productivity better than ours and how do we reach that. And currently I believe, like I said the City Union Bank would be at least 25% to 30% better productivity than us which is what we are aiming to close the gap.

Moderator: Thank you. We will take the last question from the line of Avinash Singh from Jefferies. Please go ahead.

Avinash Singh: Sir, just a question on this SME, MSME as well as mortgages. Could you help us first of all understand how much of it is in-house sourcing versus what we get from aggregators? And specifically related to SME, how much of this is typically having collateralized residential and commercial property? Because I think for the last quarter or two I think we have seen, I mean, for the sector in general some additional problems in terms of reposition and then liquidating that is getting a little tougher, so just wanted to hear your thoughts on that.

Murali M. Natrajan: So, we are operating in a market where it is not possible to avoid the connectors, aggregators, DSA and all, not possible. Our aim is to try, especially when we open a new branch and all our aim is to try and source as much as possible through our own branch sales effort rather than use some connector aggregator and so on. I would say that in larger cities definitely maybe 50% - 60% of our business comes from aggregator, connector and the balance will come from the branches. There are no deposits that come from connector and aggregators; everything is sourced by the branches because you are not allowed to use anyway those entities. And when it comes to smaller location, I would say even what 70% - 75% of our origination comes from branches. So the centralized product team is working to equip our sales team so that they can themselves generate lead either through our existing customer base or through conducting micro marketing activities and so on, that is how it is. As far as your SME NPAs are concerned, like I mentioned previously in the call, we have seen problems in the market where the loan size is big, where the loan size is small it seems like a manageable problem, customers are very well brought into this thing and if it is a self-occupied property then mostly customers do not want to give up that property so they do not want to, even if they go delinquent they want to resolve the issue amicably so that they can save their properties. So there is no question of not being able to sell their property and all, those kind of things do not arise. Larger property, not self-occupied and all is definitely a problem, there is no question.

Avinash Singh: And the delinquency levels for property backed loans and SME and individuals running very different compared to your own expectation?

Murali M. Natrajan: Our book whether it is on deposit side or on the loan side is more than 85% self-employed, I do not know much about salaried segment if that is what you are referring to as individuals. So, we do not have much of data on individuals to tell you what it is, we are a very self-employed focused organization, we do not even worry too much about salaried segment, not for deposits, not for loans. So, as far as self-employed are concerned, by definition it is a high risk segment but I would like to argue that self-employed people are much more resourceful when they get into trouble because they have a business to take care of, they have to take care of their livelihood, there is always a solution that comes up in terms of some alternative thing, it may take time but it always comes up.

So, operator, that ends our conference call. If you have missed out any questions they can send a mail to us and we would be more than happy to respond.

Moderator: Thank you. Ladies and Gentlemen, on behalf of DCB Bank Limited that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.