DCB Bank Limited

Instrument/Facility	Amount (Rs. Crore)	Rating Action (November 2016)
Basel III Tier II Bonds Programme	100.00	[ICRA]A+ (hyb) (Stable) Assigned
Basel III Tier II Bonds Programme	300.00	[ICRA]A+ (hyb) (Stable) Reaffirmed
Short-Term Fixed Deposits Programme	-	[ICRA]A1+ Reaffirmed

ICRA has assigned the rating of [ICRA]A+ (hyb) (stable) (pronounced ICRA A plus hybrid with a stable outlook) to the Basel III tier II bonds programme of DCB Bank Limited (DCB)[†]. ICRA has also reaffirmed the rating of [ICRA]A+ (hyb) (stable) for the Rs. 300 crore Basel III tier II bonds programme and the rating of [ICRA]A1+ to the short-term fixed deposits programme of the bank. The letters “hyb” in parenthesis suffixed to a rating symbol stand for “hybrid”, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss-severity vis-à-vis conventional debt instruments. The rated tier II bonds are expected to absorb losses once the “Point of Non Viability” (PONV) trigger is invoked.

The ratings at the current level take into consideration the bank’s stable asset quality given its focus on the relatively safer mortgage segment, and its low exposure to vulnerable sectors. The ratings also factor in the bank’s stable top management team and healthy interest margins albeit with some moderation in profitability in light of its current branch expansion drive. The ratings however remain constrained by banks elevated cost to income ratio and its low CASA base. Going forward, the bank’s ability to protect its profit margins, improve its CASA profile while maintaining sound asset quality will be the key rating sensitivities.

DCB Bank was formed by the merger of Ismailia Co-operative Bank Limited and the Masalawala Co-operative Bank in 1995. The Aga Khan Fund for Economic Development (AKFED) and its group companies are the largest shareholders in the bank holding an aggregate stake of 16.23% of as on September 30, 2016. The bank is primarily engaged in the mortgage lending and agri-inclusive banking catering mainly to self-employed borrowers.

The bank’s loan book grew by ~29% YoY and ~8% QoQ in Q2FY2017, to Rs. 14,436 crore as on June 30, 2016, supported mainly by the growth in its mortgage and agriculture & inclusive banking (AIB) portfolios. The share of the mortgage and AIB segments in the bank’s loan portfolio remained stable at 43% and 17% respectively as on September 30, 2016. The other key segments contributing to the bank’s portfolio include Corporate (16%) and SME/MSME (11%). Within the mortgage segment, around 75-80% of the accounts are loans against property. In the corporate segment, the company caters mainly to AA+ and below rated companies given the higher yields on these exposures. The bank’s advances are well-diversified with a relatively low exposure to sensitive sectors such as infrastructure, construction and commercial real estate. Going forward, the management expects the loan mix to broadly remain stable at its current levels.

The bank’s deposits increased by ~30% YoY and ~13% QoQ Q2FY2017, to stand at Rs 17,685 crore as on June 30, 2016. To fund its high loan book growth, the bank continued to focus on bulk term deposits, resulting in its CASA ratio declining further to 21.9% as on June 30, 2016 from 23.4% as on March 31, 2016 (23.40 as on March 31, 2015). Going forward, the bank’s ability to improve its resource profile by mobilising low-cost CASA deposits remains a key rating sensitivity.

The bank’s asset quality metrics remained healthy over the past two years, with its gross NPAs standing at 1.75% as on September 30, 2016 vis-a-vis 1.51% as on March 31, 2016 (1.76% as on March 31, 2015). Slippages during FY2016 and H1FY2017 were witnessed primarily in the mortgage, SME/MSME and AIB segments, with the corporate segment asset quality remaining steady. The bank’s provision coverage declined to 75.40% in H1FY2017 from 77.55% in FY2016 resulting in its net NPAs increasing to 0.84% as on September 30, 2016 from 0.75% as on March 31, 2016.

[†] For complete rating scale and definitions please refer to ICRA’s Website www.icra.in or other ICRA Rating Publications.

The bank's yields on advances moderated in FY2016 to 11.58% from 11.81% during FY2015. A decline in cost of funds from 7.23% in FY2015 to 7.14% however led to its net interest margins (NIMs)[1] remaining almost stable. The bank's operating expenses remained elevated at 2.79% of average total assets (ATA) as it continued to increase its branch network (branch count stood at 228 as on September 30, 2016 vis-a-vis 160 as on September 30, 2015). With an increase in slippages, the bank's credit costs also inched up to 0.30% of ATA from 0.23% of ATA in FY2016 which led to a softening in profitability with the RoA and RoE reported at 1.11% and 11.17% respectively in FY2016 as compared with 1.32% and 12.44% during FY2015. With branch expansion expected to continue during FY2017 as well, ICRA expects the bank's profitability indicators to remain subdued in the short to medium term. The bank's asset quality performance would have a critical bearing on its profitability going forward, and would be a key monitorable.

The bank reported a lower CRAR of 11.90% (tier I at 10.76%) as per Basel III on September 30, 2016 compared with a CRAR of 14.11% (tier I = 12.79%) as per Basel III as on March 31, 2016 (reported CRAR does not include H1FY2017 profits) with the bank to raise fresh tier I and tier II capital within the next 12 months to support its growth.

Bank Profile

Incorporated in 1995, DCB Bank was formed by the merger of Ismaila Co-operative Bank Limited and the Masalawala Co-operative Bank. The Aga Khan Fund for Economic Development (AKFED) and group companies are the largest shareholders in the bank together holding a stake of 16.23%, followed by foreign institutional investors at 19.96%. As on September 30, 2016, the bank operated through its 228 branches and 490 ATMs.

Recent Results

The bank reported a PAT of Rs 194.52 crore with a net interest income of Rs. 619.50 crore in FY2016 compared with a PAT Rs 191.18 crore with a net interest income of Rs. 508.22 crore in FY2015. The bank's total assets stood at Rs. 19,119 crore and its networth at Rs 1,742 crore as on March 31, 2016.

During Q2FY2017, DCB reported a PAT of Rs. 48.5 crore with a net interest income of Rs. 190.3 crores vis-a-vis a PAT of Rs. 47.0 crores with a net interest income of Rs. 177.0 crores during Q1FY2017. The bank's gross NPAs stood at 1.75% and its CRAR at 11.90% as on September 30, 2016 as compared with gross NPAs of 1.72% and a CRAR of 13.15% as on June 30, 2016.

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[1] As per ICRA calculations

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