"DCB Bank Limited Q1 FY-23 Earnings Conference Call"

July 30, 2022

MANAGEMENT: **MR. MURALI M. NATRAJAN – MANAGING DIRECTOR & CHIEF EXECUTIVE OFFICER, DCB BANK LIMITED**
MR. SATISH GUNDEWAR – CHIEF FINANCIAL OFFICER, DCB BANK LIMITED.
MR. AJIT KUMAR SINGH – HEAD TREASURY & FIG, DCB BANK LIMITED.
MR. PRAVEEN KUTTY – HEAD RETAIL BANKING, DCB BANK LIMITED.
MR. SRIDHAR SESHADRI – CHIEF RISK OFFICER, DCB BANK LIMITED.

Moderator: Ladies and gentlemen, good day and welcome to DCB Bank Limited Q1 FY23 Earnings Conference Call. Joining us on the call today are Mr. Murali M. Natrajan – MD and CEO, DCB Bank Limited, Mr. Satish Gundewar – Chief Financial Officer, Mr. Ajit Kumar Singh – Chief Investor Relations Officer.

As a reminder, all participants 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 the operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to the management. Thank you and over to you.

Murali M. Natrajan: Thank you. Good evening, all of you. I am speaking to you from our boardroom. We have Mr. Sridhar Seshadri – our Chief Risk Officer, we have Ajit Singh – our Treasury and FI Head, we have Praveen Kutty, who is the Head of our Retail Banking. We have Satish Gundewar, who took charge from Bharat Sampat with whom you have been interacting for many years as Chief Financial Officer.

So, in the first five, seven minutes or so, let me give you some highlight:

One of the important highlight that I would like to bring to your attention is that, we continue to be very strong in our recoveries and upgrades. In fact, upgrade is much higher than recoveries and so, it just tells you about the robustness of the portfolio, the slippages are high, primarily contributed by gold loans, gold loans are contributing to the slippage also to the upgrade for the simple reason that the Reserve Bank of India rule that came in November of 2021, where every day, the previous 90 days the customer has to be servicing the interest and his debit have to be lower than his credit. So, that is a pretty big challenge for small customers. Although we are spending a lot of time in educating these customers, we do find the default. And if a particular customer gets into the default or what they call as out of order, then what happens is that if they have a related loan like a mortgage or commercial vehicle, or SME, that also gets into a NPA situation. So, you have to now clear all the over dues to become. Despite that we have performed quite well on the recoveries and upgrades. I would say that commercial vehicle and mortgage which is a big product for us, the slippages are very close now to the previous pre-COVID level. And we have had some slippages in our AIB that is to be expected, especially in KCC. But what we have seen is that over a period of 12 odd months, our recoveries and upgrades are quite good in those portfolios.

So, that is point number one. The other important point is that, if you look at our financials, and I'm actually, instead of focusing on the quarter financial, I want to talk about the franchise strength. If you look at our financials, pre-COVID, you will find that operating profit divided by provisions were always in the range of three and a half, four times. This quarter, we have almost reached 70% coverage, let me remind you that we do granular secured lending. So, therefore, we have had a coverage of 70% if you look at the operating profit divided by provision, it's like more than four times which is the margin of safety, which is a strength of this franchise.

Our balance sheet crossed 45,000 crores, CASA crossed 10,000 crores and grew by 51% and we are getting the benefit of our attention and focus on our branches in savings account. And that grew by more than 60%. Our advances growth is 18%, our disbursements were almost the same as the fourth quarter. We had lower disbursal in co-lending and we are looking for more partnership because we set up limit on each co-lending and when you have to when we cross a limit it take time for us to get new limits on those lending to get that going. But that is nothing to worry about our core lending, core disbursals are doing quite well and we expect that to step up further, as we have grown our branches in the last quarter as well as the fourth quarter of last year. Plus we have also added a lot of frontline staff. About 85% to 88% of our total staff are facing the customer and supporting business. So, our overheads are very limited in our business.

We have done well on the operating profit, core fee income is doing well. Last year we had the benefit of 154, 155 crores of Treasury income, the interest rate is not supporting that type of opportunity. This year our same to same, we had an income of about five, six crores, we didn't have any of these Treasury losses so that is what it is. In terms of profit after tax obviously it's a very high number last year first quarter was a difficult quarter, we had to make a lot of provisions and it was the massive very difficult second wave that we had to deal with. Since then, our recoveries upgrade have done quite well. Our restructured portfolio is doing building up. Most of our restructured portfolio is secured either home loan or loan against property. So, that is also doing well….CASA ratio is moving up, which is also a good sign our intention is to cross the 30% as soon as possible.

NIMs, we have a five, seven basis point challenge primarily because of excess liquidity which we had to maintain in the start of the quarter as the business was taking time to pick up that dampened the NIM a bit, but our stable NIM that we expect should be in the range of 365 to 375 basis point.

In retail and SME business, which is very pure business that we do is cost do come in first. But as we build volume, we expect the cost to average asset as well as cost income to come down. We also expect the slippage especially of mortgages and commercial vehicle and SME to be at the same level or below pre-COVID levels in about two to three quarters that is what our expectation is and we also expect our credit cost to be definitely lower than last year credit cost. Our intention is to maintain the credit cost in the range of 50 to 60 basis points.

We are still having a lot of success in our digital agenda. One of the products that we launched called Zippi+ even without any digital marketing, we are getting more than 100 customer opening account with us. Our intention is to do digital marketing to step up this and I would encourage you and your friends to try out Zippi+ in the Playstore and your experience and your feedback would be quite useful to us. With those words, I would like to hand over to the operator to pick up the questions I'm happy to answer the questions.

Moderator: Thank you very much. We will now begin the question-and-answer session. We take the first question from the line of Mona Khetan, Dolat Capital. Please go ahead.

Mona Khetan: So, firstly on the SME segment. So, while we are seeing healthy disbursals, you shared this data on segmental disbursals this quarter, that is not really translating to grow so what exactly is happening, is it the competitive intensity or there's more to read into it?

Murali M. Natrajan: What do you mean it is not translate into growth?

Mona Khetan: So, if we look at the loan growth from a sequential perspective, its below the overall growth whereas disbursals are better than the other segments for SMEs?

Murali M. Natrajan: Yes, so we have had some decent growth in mortgages, loan against property, gold loans when you disburse 100 almost 60, 70 of them get repaid. SME utilization is a challenge always in first quarter, because they use a lot of loans in the fourth quarter and then in the first quarter the utilization comes down and is expected to pick up. One of the products that we do is that is – TReDS. TReDS is a very short cycle product it's maximum of 90, 120 days. So, we pick up the disbursal of that much more than what we do. So, that's how the dynamics of the business is. We are very confident that given the momentum that we are seeing on new disbursals, on mortgages, tractors, KCC and also gold loan and new sign ups that we are doing on co-lending, etc we are pretty confident of our traction.

Mona Khetan: Sure. Sir, when we look at some of the larger private banks, they are growing very fast, the branch expansion plans are significant. So, that you don't see as a risk to your mortgage and SME book the growth in those book?

Murali M. Natrajan: The segment that we are concentrating is 30 to 40 lakhs kind of average ticket size and our competition intensity while it is there, we understand this segment very well. The kind of volumes that we are seeing, the logins that we are seeing, we are pretty confident that our growth what we are projecting or doubling the balance sheet in three to four years should be possible.

Mona Khetan: Sure. And secondly, so when we look at gold slippages we have seen three high slippages on the gold segment in the last three quarters in a row now. So, do you expect that to normalize the here on?

Murali M. Natrajan: So, let me explain the slippage, so that you understand. These are all customers average ticket size of two to three lakh rupees. We are offering a product called overdraft product, when they take loans from say NBFC they get a bullet loan, but we are giving them overdraft product, where we are trying to make them into, getting them into a habit of servicing their interest on a monthly basis. Prior to November 2021 on March of any particular year that is 31st March any particular year if the customer had serviced their entire interest that is the last 90 days whatever debit, credit, the credit is more than the debit they are not considered as NPA even if during the quarter on any particular day they had not serviced the interest, that was the RBI guidelines at that point in time. RBI guidelines changed in November to say that on any particular day not any month, any particular day the previous 90 days the customer interest should have been serviced. So, these customers are not so, what do you call it, disciplined in terms of operating their account. And that is the reason the slippage increase but when you follow up, they pay all the over dues and become regular. So, till the time we have this product, we expect this, that customers are used to this product, they like this product, but we need to get them to have the discipline of that. There is no risk to the portfolio because underlying is gold loan and you can see that the recovery is pretty much in fact higher than what the slippages are.

Mona Khetan: Okay, sure. So, across couple of products including non-gold and gold the slippages have largely been impacted by the out of order circular as well as the November circular as you mentioned?

Murali M. Natrajan: Out of order circular of November. Out of order circular was always there, but in November it changed to everyday 90 day, that is the change actually. And I explained even in my previous call, I'm sure I don't know how the other banks are dealing with, we have started right from November, we have started following that circular. And SME also, but some of the SMEs have understood this issue and have started becoming more disciplined about servicing their interest. They are not bad customers, they are just and you know that sometimes the SMEs get their cash flows in a slightly erratic manner so they don't service it those becomes NPA, then they service all the interests and become standard and start operating their account like a normal account.

Mona Khetan: Got it. And so thirdly on the EBLR loans, do you see yourself passing on the entire rate hike to borrowers or there could be some compression in risk premium as well?

Murali M. Natrajan: No, we will be passing on this thing we have already, 40 basis points we have already passed, 50 basis point will get passed on in August.

Mona Khetan: Okay. And the reset is three months?

Murali M. Natrajan: Yes.

Mona Khetan: Okay. And just finally, what would your slippages from the ECLGS?

Murali M. Natrajan: This all contained in the total slippages as you know, I kept telling you, I don't know why we get this question again and again, we had 2000, 3000 crores of sanction, we only disbursed about 1000 odd crores of ECLGS, because we knew that customers #A, will have difficulty because the customer who is doing a 10 year loan suddenly has to start paying after one year the principal also, it gets too compressed and it will burden the customer. All slippages that we have reported include the ECLGS slippage, restructure slippage, whatever slippages are available all have been reported.

Mona Khetan: Sure, but if I look at the restructured, the outstanding has remained same versus last quarter or hardly any difference which means that the slippages have not been.

Murali M. Natrajan: It has dropped by 60 crore, but what is wrong, that is the restructured portfolio and he is paying it's installments.

Mona Khetan: Right. But just wanted to get a sense that out of this 1000 crore, have there been any slippages is in the last few quarters?

Murali M. Natrajan: What is 1000 crores?

Mona Khetan: Of ECLGS disbursals?

Murali M. Natrajan: Like I mentioned it is part of the slippage and upgrade, therefore slippage it is also and upgrades also all those.

Moderator: Thank you. We take the next question from the line of Rohan from Equirius Securities. You may go ahead.

Rohan Mandora: What was your quantum of NPA that was upgraded during the same quarter from the slippages?

Murali M. Natrajan: I don't have a number, why do we need that?

Rohan Mandora: Just to understand what was the slippages adjusted for the recoveries within the same quarter?

Murali M. Natrajan: Some of the slippages on gold loan would be within the quarter quite possible.

Rohan Mandora: Right, Second is, so what is the coverage that we are carrying on gold loan NPA?

Murali M. Natrajan: Coverage on Gold loan NPA means?

Rohan Mandora: Under the provision that we are carrying on the gold loan NPA?

Murali M. Natrajan: Again, I'm not understanding the reason for the question, the total coverage ratio is 69 something, including gold it is like 70, excluding gold it is about 72 odd percent, gold loan actually doesn't require any coverage. We never lose money in gold loan, but in any case we will provide the 15, 20, 30 whatever percentage depending upon the aging.

Rohan Mandora: Sure sir. And sir the credit cost guidance of 50 to 60 basis point that is for FY23 or how are we?

Murali M. Natrajan: On a steady state we expect credit cost to be 50 to 60 basis points. More like 50, 55 basis points and we do expect credit cost to be based on what trend we see in the last two quarters, we do expect credit cost to be lower than last year in this year.

Rohan Mandora: Sure. And the steady state is expected by when?

Murali M. Natrajan: Steady state is as and when we kind of come back to normal slippages which we expect in about two to three quarters, normal slippages means, we are talking about pre-COVID level slippages for commercial vehicles, home loans, mortgages like that.

Rohan Mandora: And sir lastly almost 20% new employees in last three quarters, so just if you can elaborate on how they are deployed

Murali M. Natrajan: They are all deployed in various businesses mortgages, home loans, gold loans, CASA, term deposits, KCC, tractors like that and operations because we have to support them operations, credit operations like that and some we have added to our technology as well.

Rohan Mandora: Sure. So, it's across the board and no specific segment per se, in terms of focus areas?

Murali M. Natrajan: What do you mean by segment?

Rohan Mandora: Any particular segments which we would have been trying to focus more for example, cross sell or something like that while we will be strengthening bench?

Murali M. Natrajan: We have added people to mortgages, home loans, KCC, tractors, gold loans all are businesses depending upon the potential, depending upon the geography, depending upon the branches. Obviously, we add sales people, then we have to add credit people, then in some proportion we have to add the credit people. Some other people we added for operations to support this. So, like that we have added across the board.

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

Renish Patel: Two question one is sort of on the clarification. So, we have mentioned that we target gross NPA to be below two and a half and net NPA below one and a half basis for FY23 or this is a slightly medium term basis?

Murali M. Natrajan: Way forward means when we are talking about a foreseeable future, three, five, six quarters like that. We don't give any guidance on particular year. So, you see that we are talking about four, five quarters like that, we are not giving any guidance or any particular specific financial year. If you recall, pre-COVID our NPAs were always below 2% on gross and net 1%. Now, in COVID, a lot of slippages happened and you can see that we are doing a remarkable job on recoveries and upgrade, you can't point a single bank that does almost 100% recovery and upgrades, in fact more upgrades than recoveries. So, based on this and based on the kind of growth when we are having, we expect NPAs to come down to 2.5% ovea period of time.

Renish Patel: Got it sir. And the last sort of strategic question on let's say, over the next three to four years when we expect our balance sheet to double. So, by and large, we expect the same product mix, which we have currently or there will be some products which will grow at a faster clip and maybe our product mix could change over a period of time?

Murali M. Natrajan: First of all we will continue to be granular, second, we will be continuing to be secured that is not going to change. 84% of our loan is below 3 crores. Top 20 exposure is below 5%. So, we're not going to change that strategy, what is likely to happen if we are able to execute our plans well is that mortgage which is around 47%, 48% both put together that is AIB and retail put together could be higher than 50%, 55%. And gold loan could increase and because we have to achieve the agri target KCC and tractors also be, so the lead would be the mortgages, KCC tractors, gold loan, and we also expect co-lending to contribute anywhere from 4% to 5% of our book, provided there is no change in regulations on co-lending, the current norm seems to indicate that we can achieve that kind of growth.

Moderator: Thank you. We take the next question from the line of Neel Mehta. Please go ahead.

Neel Mehta: Just, wanted to check with you what's the duration of our Treasury portfolio would be considering the rising interest rate scenario?

Murali M. Natrajan: What portfolio?

Neel Mehta: The Treasury portfolio, there is portfolio of bonds in our book?

Murali M. Natrajan: I don't think we disclose that detail. All I can say is that in this quarter we did not have any loss in our Treasury, we made a small profit of about 5 crores. And last year, same time because interest rates were moving in the right direction from a profit point of view, so we were able to book about 50 odd crores of profit.

Neel Mehta: Got it sir. And if you could also disclose the percentage of your book in floating rate loan?

Murali M. Natrajan: Again we don't disclose that detail. I've also already mentioned that, our portfolios except for tractor, commercial vehicles, and to some extent gold loans rest of the portfolio are all linked to either EBLR or MCLR depending upon when they were originated. And we contractually every quarter, every three months we pass on the increase as and when we do that.

Moderator: We take the next question from the line of Jai Mundhra. Please go ahead.

Jai Mundhra: So, this is a slightly longer question. So, I would request your patience. So, if I look at last four, five quarters there are slippages and there are recovery upgrades as well. So, GNPA is more or less static, during the last four, five quarters the write off of course has been miniscule. And it looks like that is also one of the reasons why your specific credit cost is also muted. This quarter if I were to calculate credit cost is around 45, 50 basis point. So, it is clearly coming because the portfolio by design or by choice is such that the write offs have not been there in the last four, five quarters. Now, the question is sir when you say 40, 50, 60 basis point credit cost should one assume that the portfolio quality would remain more or less similar in the sense that you may not need too much of a write off or there is something else also?

Murali M. Natrajan: Portfolio quality is not impacted by write off. Write off only reduces the gross NPA. Portfolio quality is impacted by the slippage, recovery upgrade and the consequent credit cost. Write off does not impact the credit cost.

Jai Mundhra: You are saying write off does not impact the credit cost?

Murali M. Natrajan: Yes, because you normally write off only 100% provided portfolio we don't write off portfolio and we write off portfolio very miniscule because we don't see showing the lower NPA by just doing write off, we have to achieve a lower NPA by recoveries and upgrade and if you see mortgage which is more than 50% almost 50% of our portfolio, the NPAs have consistently come down you can see that and commercial vehicle has been pretty stable. Some uptick is there in SME, part of it is because of the November 12 circular we are pretty confident there are some slippages that have happened in AIB portfolio, which is a KCC and all it is more situational and we are pretty confident about that as well. And our MFI portfolio which slipped during the COVID time we have provided more than 90% or even 100% in some of the portfolios. So, improvement in credit quality will come by lesser slippages, continued better recoveries and upgrade that is what we expect. And we have already had 70% odd coverage ratio. So, therefore, we are covered to a great extent on our NPA.

Jai Mundhra: No, so I am saying sir for the full year FY22 the total write off were very miniscule at 80, 85 crore and this was clearly the period when a lot of unrecoverable assets would have come through from previous COVID wave and of course the second COVID wave was also very problematic. So, I'm saying that year the total write off was 80 crore only and hence your credit cost was less impacted. Would that be a right sense to sort of a forecast that despite higher slippage the write off may not be very high?

Murali M. Natrajan: Once again I am telling you that, credit cost is impacted by provision, provision is impacted by gross slippage, minus recovery and upgrade. Write off our bank does normally 100% provision is done on a particular portfolio or we find something for any reason is completely not recoverable. We do secured lending. So, we don't assume that anything is not recoverable and we are demonstrating that by actually having upgrade and recovering. So, I suggest that you leave the write off connection on this credit cost. What we expect is consistently we will be having lower slippages and continue to have good performance on our recoveries and upgrade. We have almost +900 people in our collection in-house not outsourced, in-house. So, we are confident now that the economy is bouncing back, SMEs to whom we have led are having better cash flows so, we are confident that we will continue to do well on our recoveries and upgrades, that is how our credit cost will be lower.

Jai Mundhra: Okay. And second question is sir on your loan growth. So, while we go by this thing of doubling the balance sheet in three years or 3.5 years, if I look at last three, 3.5 years, the accumulated loan growth in the loan book is around 30%.

Murali M. Natrajan: Look forward, we took a defensive position in 2021 and part of 2020, we have already added people and branches, we have added capacity in all our products like I explained a few minutes ago to another investor. So, based on the investment we have done in the branches and the frontline and the capacity, we expect to double the book in three to four years time.

Jai Mundhra: Right. So, that essentially means, incrementally there is less COVID impact and there is less competitive impact this is.

Murali M. Natrajan: COVID impact, I don't know, competition impact is always there from 2009 since I took charge we have always operated under competitive pressures. Despite competitive pressure, we understand the segment, the segment is very large, we understand our products, we have distribution, we have capabilities, and that helps us to continue to march forward on this journey.

Moderator: Thank you. The next question from the line of Rishikesh Ojha from Robo Capital. Please go ahead.

Rishikesh Ojha: My first question is on the OPEX which is up quarter-on-quarter, can you please comment on that and are they like going to be at elevated levels for this financial year?

Murali M. Natrajan: From the last quarter, or even from the third quarter of last year, we have been investing in front line like I explained it is broad based, we are investing in mortgages, we are investing in KCC, tractors, branches to support them in credit and operations. So, I expect operating cost to be high this year. But moving forward, we expect like we have guided in about four to five quarters, we expect cost income ratio to be 55% or below and also reduction in our cost to average assets. That will build our loan and deposit book.

Moderator: Thank you. We take the next question from the line of Rakesh Kumar from Systematic Share. Please go ahead.

Rakesh Kumar: Sir, just a very basic question here. I have seen your cost of deposit number though, very marginally it has come down, we have relatively lower CASA deposit percentage as compared to the system. And interbank term deposit number is close to around 13%. And we are in a rising interest rate scenarios. So, what is helping us to reduce our deposit cost?

Murali M. Natrajan: See, the deposit rate for term deposit or even for our savings rate, if you don't offer competitive rates, especially for bank of our size we will not be able to attract the right level of deposits. So, the comparable set of banks we have to always compare our deposit rates with those banks, because we are in the market competing with some of those. Now, our intention is to grow our savings deposits, we have a graded pricing on savings deposit, and we expect those to be sticky. And also what we found is that if we get a deposit of savings this month, by 12 months the deposit at least increases by 30% even without any great effort in cross sell and so on. So, we expect that to help us in managing our cost of fund. However, I can tell you that deposit rates are increasing and we have to remain competitive, we need to make sure that we don't take, we keep granular deposit portfolio because with our top 20 deposits as we know is about 6.2%. So, we may have to match those rates in term deposit and all in order to support our liquidity requirements. The good news that you also have is that our portfolio is all refinanciable. We do get refinance from SIDBI, NHB and NABARD. We do 60% odd of our book is PSL. So, we are required to keep only 40%. So, we get a lot of refinance support, which comes on a longer term plus it does not attract SLR, CRR. Last point is that, if you keep our your slippages in control, and have decent recovery and upgrade, NIM also does not get damaged by any reversals and so on. So, there are a lot of factors that play into it also, you have to achieve your agri target, if you don't achieve agri target, then you will be lumped with long term RIDF which will be coming at a very small low rate. So, there are so many factors in this cost of funds and margins which all have to be managed.

Rakesh Kumar: Got it sir. So, just to slightly reverse this question, if you look at March 22, and June 22 number as during the press release. So, like you know there is a strong growth that we have seen in the investment number as compared to advances number. So, is it better for us to keep deposit rate lower. So, that, we don't require that much of resource because anyway, we are sitting at the excess security. So, is that also the thought process?

Murali M. Natrajan: No. Some point of excess liquidity has to be kept to ensure that you meet all the LCR norms and some part of excess liquidity is created because of short term lending in corporate. So, this is our daily activity, every day we monitor all this items. And first quarter usually is not a very great quarter in terms of business, because April starts off very slow. So, you probably had some excess liquidity at that point in time. So, we expect all that to normalize in the next quarter or so.

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

Mahesh MB: Maybe just one question. If you can give some update of situation of your borrowers in terms of how are they feeling in terms of the recovery in business environment?

Murali M. Natrajan: Which one?

Mahesh MB: What is the general feeling of the business on the ground**?**

Murali M. Natrajan: The business on the ground feeling is pretty positive not much issues, like I don't think in our case meeting our balance sheet meeting that we have, we are finding any resistance or any issues. We had, today in our Board meeting we had invited CRISIL to come and present to us about the challenges of the economy to our management team and Board. And we got a very balanced view from this very learned and expert Dharmakirti Joshi, and his team also we ask questions around the SME, micro SME, and so on. And they also understand the robustness of this sector. So, on the whole while there are challenges in terms of inflation and other pressures, I don't see too much negativity in the sentiment of our sales team or frontline. But partly you see that the other thing, like if the inflation is like that, then your salary adjustments have to be in line with those kind of pressure. And that is part of the reason why you see a little bit of cost increase in the first quarter in terms of the salary increase as well.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to the management for closing comments.

Murali M. Natrajan: Thank you very much for all of you to login into this call. Look forward to talking to you again next quarter. Thank you.

Moderator: Thank you. On behalf of DCB Bank Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.