"DCB Bank Limited Q1 FY24 Earnings Conference Call"

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MANAGEMENT: **MR. MURALI M NATRAJAN – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER**
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Moderator: Ladies and gentlemen, good day and welcome to DCB Bank Limited Q1 FY24 Earnings Conference Call.

Joining us on the call today are Mr. Murali M Natrajan – Managing Director and CEO, Mr. Ravi Kumar – Chief Financial Officer and Mr. Ajit Kumar Singh – Chief Investor Relations Officer.

As a reminder, all participant lines will be in the listen-only-mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on the touchtone phone. Please note that this conference is being recorded.

I now have the conference over to Mr. Murali M Natrajan. Thank you and over to you, Sir.

Murali M Natrajan: Thank you very much. Good evening all of you. Welcome to the Quarter 1 FY2024 Investor Call.

First of all, let me sincerely apologize to all of you for delaying this call by 15 minutes. The reason is that we had some technical difficulty in uploading the information and that took us a while to sort out that technical problem. Otherwise would have given you more time to go through all the information.

I'm joined by our Management Team here. Praveen Kutty, who is the Head of Retail Banking, we have Ravi Kumar, who's CFO, we have Shridhar who's the CRO, we have Venkatesh who's Operations, Technology and HR Head and then we have the rest of the Management Team.

This is about Quarter 1 FY 2024. So, in the first few minutes I'll give some highlights and then we will open up for questions.

Our interest income growth has been in line with our average balance sheet growth on a year-on-year basis. As I had mentioned to you in the last call that in the EBLR methodology, we increase the interest rate of customers as the EBLR is changed by RBI and whereas the cost of fund impact comes through later and that is why you see some level of reduction in our NIMs, but it is still higher than and in line with our business model, which is what we have been talking about.

Core fee income seems to be growing in line with the balance sheet. What I would like to mention is that one and half years ago we used to have a substantial amount of income from PSLC. Unfortunately, that whole income stream has more or less disappeared. Although we do sell PSL but the rates are so weak that the income is not substantial anymore. But still we have been able to make up through other income stream.

We've had reasonably good control over the speed at which expense is growing. You will notice that our total income growth, which was lower than that total expense growth last year, this year we are more or less in line with that. Of course, we will continue to make investments in the

frontline in order to double our balance sheet in the timeframe that we had mentioned in the strategic areas, core areas like mortgage, co-lending, AIB, Construction Finance and SME.

In terms of credit cost, we are still very much in control of credit cost, although there has been a slight increase in NPA. This is primarily on account of now most of the loans have come out of moratorium, a very small portion is left which also would be finished by July and we had some delays in terms of recovery and upgrades, but we are confident that over the next one to two quarters, we'll be able to catch up on that. And as you know, last year every quarter we have been able to deliver almost equal to the slippages and we expect our recoveries and upgrades to pick up momentum in the coming months.

Overall, usually the 1st Quarter is slightly lower, but if you look at our year-on-year deposit growth, it has been about 22.6%. And if you look at our loan growth is about 19%. This is despite the fact that TReDS portfolio, which is the invoice discounting portfolio that we were doing on the platform that disbursal was very low in the 1st Quarter. We hope to pick up because the rates were not so good and we decided not to participate in an unprofitable kind of thing but we think that this momentum will pick up in Quarter 2 or Quarter 3. And other than that, of course the rest of the businesses are functioning well and we are seeing momentum in that.

We have opened about 8-odd branches in line with our 25 to 30 branches approach.

Our capital adequacy continues to be strong. The entire banking industry, many of the results that have been declared have had some struggle on CASA because the interest rates have been high on term deposit. There has been some flight of money from CASA to term deposit. We have also experienced such a situation but we are putting more efforts on CASA ratio to try and reach our long term stated goal of 30% above.

The cost of funds increase is in line with our expectation and we think that there may be a little bit more increase in cost of funds, although not at the same pace at which it has happened in the last two quarters.

Those are some of the highlights I wanted to share with you, I am happy to take questions.

Moderator: Thank you very much. We will now begin with the question-and-answer session. We take the first question from the line of Mr. Suraj Das from B&K Securities. Please go ahead.

Suraj Das: A couple of questions are from my side. On the disbursement, I can understand there is seasonality in the 1st Quarter as you mentioned in your opening remarks as well. Just wanted to check one specific line item MSME and SME disbursement. I think that is very low compared to last quarter it was something around 840 cores and now it is only 384. So, is this because the TReDS portfolio has come down as you mentioned in the opening remarks or there are any other thing that has caused this? That is the first question, Sir.

Murali M Natrajan: So, there are two parts to our MSME/SME lending. The substantial part of our MSME/SME lending is the normal CCOD term loan type of product, which is the largest portfolio. Then we had embarked upon trade about 1.5 to 2 years ago and it has performed very well without any NPAs. And it has helped us to park our excess liquidity as you generate because there's always a mismatch between generation of deposits and like for example while some refinance from NHB, it comes in a big quantum and it takes time for you to disburse those money. So, those kind of excess liquidity we park in TReDS. For whatever market reason from March 2023 to almost till June 2023, we found that the interest rate that was prevailing in the TReDS was not something that we wanted to participate that is no. 1 and no.2 also there was some change that we still have to understand in regulatory guidelines, in terms of what is the risk weight that you can assign to the loans that you generate because our understanding of the guidelines seems to indicate that we have to have a specific rating of the principal else we'll have to keep 100% risk weight. So, with the lower interest rate and the higher risk weight, it doesn't make sense because it will not beat our 14%, ROE. So, we backed off from that. So, the disbursal that you see in low volumes on SME/MSME is almost 90%-95% because of TReDS.

Suraj Das: The next question is on the yield on advances, this quarter if I see on quarter-on-quarter basis, so it has declined by around 12 basis point. So, just wanted to know what are the reasons probably behind this because ideally, other banks, they are seeing QoQ rise in the yield on advances.

Murali M Natrajan: See, it depends on the mix of products. There has been no change in our strategy or any issues regarding that. Supposing we disbursed a little bit more of corporate or let's say for example, co-lending, we might end up having slightly lesser average yield on advances. So, we don't expect any major issues in terms of the product mix and the yield on advances. So, as we pick up more momentum in our core products like AIB and Mortgages in the coming months, I believe that unless there is some substantial competitive issue or something we should not have any problem in this and we still want to maintain that our business model is in the range of. 370-375 basis point NIM.

Suraj Das: And last couple of questions from my side is Sir one on the slippages side, so there has been QoQ rise in the slippages, I just wanted to check is this still driven by gold or if there has been rise in non-gold slippages as well. So, if you can give any qualitative color or if there is the amount handy if you can break up the whole slippages into gold and non-gold and the last question would be on the management transition side. So, if you want to make any comments or anything?

Murali M Natrajan: So, you can have a look at Page no. 25 of the Investor Presentation where we give you the fresh slippages, some amount of slippages have happened in the mortgages, especially home loans. And this has come from the last bit of moratorium kind of customers that came out of moratorium. Now the end of August we probably have near zero in terms of moratorium. Also, what happened is that in April we did have a few holidays so when some chunk of portfolio comes out of moratorium and you have holidays, it hasn't given us enough time to kind of get these customers to perform, but our collection team has looked at it. We have analyzed the

portfolio. We don't see any long-term challenges or anything like that in this portfolio. And as a problem also our recovery and upgrades did not fully keep pace this quarter with the slippages which used to be the case for us in the last four or five quarters.

Suraj Das: And the last one, the management transition if you want to make any comment?

Murali M Natrajan: You are talking about CEO transition because management transition is very big because I'm not aware of any management transition, CEO transition Korn Ferry has been appointed as the as the search firm. A search panel has been formed of the board and we are in the process of shortlisting both internal and external candidate and we hope to conclude the process well in time for us to be able to make our application to Reserve Bank of India.

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

MB Mahesh: Just one question. I didn't get the answer that you gave to the previous one and the opening explanation on the margin side, while you alluded to the fact that it is the EBLR timing differences on the margin impact but there seems to be a drop in the yield as well. How do you explain that?

Murali M Natrajan: Yield is a quarterly from some product mix change. For example, if we have done more of a co-lending, which is coming at a lower rate but lower capital this thing and less of let's say business installment loan, that mix can impact yield. So, I don't see any concern in our yield. If you recall, kindly look at my last quarter transcript, the EBLR was like this that as soon as RBI changes the repo rate, we change the EBLR plus the margin of course is standard. So, we change the rate in our system, right. So, which is what I said that you get the benefit of the interest income. However, the cost of funds takes time to catch up, so cost of funds in fact it started increasing, our cost of funds increases probably from the end of February to March itself, and then we see that cost of funds is playing out. That is why last quarter also I said that we should not say that the NIM of4% plus is kind of a sustainable NIM so that is what my explanation is.

MB Mahesh: And looking at your funding mix today and the term deposit book, we are currently at about a 6.7 on the cost of funds where do you see this peaking out in the next two quarters?

Murali M Natrajan: I feel right now, the interest rates are not increasing at the same pace as it was increasing last two quarters and we also have done some work on changing the profile that we go and target in terms of deposit. And third point is one more thing that you have to see is that we repaid a lot of our Tier-2 bonds I think by December and then we took 300 crores of this thing in almost by end of March. A little bit of the cost impact is coming from Tier-2 also. That is why the 4th Quarter NIM was slightly higher than the previous quarters. Also, we have had a slightly higher slippages, so that also would have had some 3-4 basis point of hit in NIMs for this quarter.

MB Mahesh: My last question on the reduction in employee headcount from 9900 to 9579 Any color to it?

Murali M Natrajan: In order to scale up our business, we had a particular methodology by which we were giving headcount to all our business managers and respectively to the functions that are supporting this front line. So, in our internal meeting, we wanted to raise the bar and improve the productivity so we agreed on a new set of productivity norms for the various units and we impose that productivity. In that productivity now what happens is that if a particular unit does not meet the productivity, they get less replacement of headcount till they reach that type of productivity. So, the whole adjustment period is going on in terms of everyone working towards a better productivity in terms of disbursal, in terms of the number of files they process and so on. This headcount increase should start to pick up again from this quarter.

MB Mahesh: Just to clarify, as a consequence of this, does it have an impact on growth but improvement in cost-to-income?

Murali M Natrajan: See what happens is when you hire a set of 100 people in the front line, X percentage is anyway unproductive for a while. That means if we don't replace that, that doesn't mean that our disbursal or volume is impacted so that will be very sensible about how we want to do these replacements. It doesn't affect our businesses anyway.

Moderator: Thank you, Sir. We take the next question from the line of Mr. Darpin Shah from Haitong India. Please go ahead, Sir.

Darpin Shah: So, on the asset quality front while you explained about mortgages that there was slippages because of moratorium. There is a slight increase in NPAs in the corporate book as well. So, if you can just highlight what happened there.

Murali M Natrajan: See, there are two things that I find very difficult all these years to explain. One is any slippages from a very small corporate portfolio that we have. Another is NIMs because it has got so many moving parts. But having said that, what happens is that if any account is even under some stress where they are paying with delay and then if there is any creditor goes to NCLT then automatically the account becomes NPA even the monies that are coming through from the customer to bank gets stopped because it's all controlled by the RP, I'm just describing the process loosely that is what happens in that. So, one such account has flown into this thing and we are working towards getting recoveries. Corporate recoveries are usually the very difficult ones because you have to work with several banks to make that happen, and that's what it is. Other than that, on mortgage I explained that last of the moratorium and all people are coming out of the moratorium and we had very less number of days to collect from this both from a recovery and upgrade as well as slippages. Therefore, we went deep dive into the portfolio to see whether there are any challenges. We haven't found any major issues or concerns for us and we hope to pick up momentum on this in the coming quarters.

Darpin Shah: Sir, just one last data keeping question. If you can provide the breakup of provisions, standard assets and NPAs and floating provisions?

Murali M Natrajan: So, we have floating provision of 4 and standard asset provision of 4 and the rest of it, NPA provision of 30.

Moderator: Thank you. We take the next question from the line of Mr. Rakesh Kumar from B&K Securities. Please go ahead sir.

Rakesh Kumar: Sir, on the PSL thing like we have seen that in PSL Agri, micro enterprises and PSL general also, weighted average premium has actually come down. But PSL small and marginal farmer, the weighted average premium is close to 2% and remains the same across the last 5-6 years. So, are we trying anything to do on the small and marginal farmer PSL to sell any PSL possibly there? And what is the reason that rates have dropped so much?

Murali M Natrajan: The rates have dropped too much. What we understand from the market information is that the Udyam certificate, which was one of the difficult thing to get and we had done a fantastic job of getting all the Udyam certificates on the MSME, also was helpful for us to get revenue plus I think there was some more time given by the regulation in terms of obtaining these certificates, so that is also the reason why I think it has dropped and probably there are more sellers in the market because of which the price is reduced. On small and marginal farmers there, we do have a separate unit within the Agri unit working on that. But the challenge there and not that I'm saying it is not doable but the challenge is the collection costs for these small customers is very high because we are talking about ticket size of like 5,00,000 and maybe 3,00,000 and 4,00,000, that's kind of marginal and the holding will be less than 5 acre, Ajit, right for marginal farmers. So, therefore it is also a challenge in terms of both operating costs and collections. But having said that, we are working on it. We are also tying up with some what you call as Agri tech kind of companies who have been able to scale up to some level for giving to these marginal customers. We are trying to tie up with them to see how we can improve that. We are putting some money into technology to make this whole process a little bit better so that we don't fall short of this small and marginal farmer thing because that seems to be getting the maximum amount of pricing in Agri, you're right.

Rakesh Kumar: Yes, because it fulfills for couple of other categories shortfall also.

Murali M Natrajan: And see the way it works; I think is that something can be countered in Agri weaker section and small and marginal farmer depending upon the size of the loan and the category.

Moderator: Thank you. We take the next question from the line of Mr. Gaurav Jani from Prabhudas Lilladher. Please go ahead, sir.

Gaurav Jani: Can you quantify the slippages from the restructured pool that came through this quarter?

Murali M Natrajan: Yes, I have mentioned even in the past calls that there are slippages from restructured. There are slippages from the non-restructured standard. There are slippages from ECLGS. So, all that put together is 340 crores. There are also possibilities that there are customers who have paid all their dues, upgraded maybe 6 months ago, one year ago who may have slipped into NPA because

that is the nature of the SME business. If they have got some cash flows, they may have slipped into NPA. To give you a sense, on our restructured portfolio, we are already holding at least about 14%-15% of provision. And when restructured moves to NPA, the provision also moves along with that right? Second point is we did not restructure anything which is on unsecured, probably miniscule of our portfolio unsecured would have restructured. It is a secured portfolio. And I can say that much of the slippages in this quarter at least have come from home loan kind of business and self-occupied property. So, we don't see any concern in terms of its recoverability over time. And also, Gaurav, if you have seen that we have shown demonstrated ability in terms of our recoverability of this portfolio over a long period of time.

Gaurav Jani: Sure. Sir, where I was coming from is we have a restructured pool remaining of 1600 crore. Basis your opening remarks, I think we expect this to come up for repayment by July, right the entire portfolio.

Murali M Natrajan: No. We have been giving you some numbers, not all the portfolio is in moratorium. By August, even the small amount of portfolio which is like maybe 150 or whatever crores would be out of the moratorium. When we restructured, it is not that all the portfolio was given moratorium. So, please correct that in your thinking X percent of the portfolio, I think I've given some number in the past. I think a couple of quarters ago you would see that number and all the portfolio restructured is not in moratorium. Please understand that, right. Some part of the restructured was in moratorium, and that is also getting over by August end.

Gaurav Jani: I understood. And sir if I had to question you on the recoveries, right? So, could you elaborate as to what led to slower recoveries this time around and how should we look at?

Murali M Natrajan: I would say combination of things. I think we dealt with a few extra holidays in April. Usually, the first quarter is a bit slow. Second thing, some part of the North was not accessible because of the disruptions in flood. But when we look at the portfolio comparison with what we have done recovery in the past and there is no difference in that. So, over a period of next 1 to 2 quarters, we will pick up speed on this portfolio as well.

Gaurav Jani: So, lastly on the margin, if I look at your data disclosures correctly for the entire of FY23, would we have made about 3.9% overall margins for FY23?

Murali M Natrajan: Yes, 3.93. Yes, the full year was 3.93.

Gaurav Jani: Sir when I was coming from basis this how should we look at entire of FY24 and while you did mention your guidance of 3.65 to 3.75….

Murali M Natrajan: I stick with my guidance. There was some advantage we had last year also because when you get a recovery of a NPA, you also get the overdue interest and so on, which helps in your NIM. So, we had some advantage. In the early part of last year also was cost of funds was much lower than what it is currently. Our intention is always to make sure that the mix of products on the loan side and the mix of products on the deposit side is such that we make at least 365 to 375

basis points. Our intention is to make it at the higher end of the 370-375 basis point NIM because that is how our business model works. Also keep an eye on always this meeting the agri target, small and marginal farmer target and all so that we don't get penalties from NABARD and SIDBI which results in reduction in NIM. That's basically how we kind of work on this.

Moderator: Thank you, sir. The next question is from the line of Mr. Rishikesh Oza from RoboCapital. Please go ahead, sir.

Rishikesh Oza: Sir, my question is with respect to the OPEX. So, what OPEX growth do we project for FY24?

Murali M Natrajan: We don't give guidance on OPEX growth. Our intention is to grow OPEX slower than our income. Our intention is to continuously work on frontline productivity. I gave some details on how we are trying to work on frontline productivity. So, over time, we want to have at least difference of 2% to 3% between the income growth and cost growth, that's the way we are functioning. Our intention is to reduce the cost to average assets. So, this year, this quarter you would see that there has been a slight dip in cost to average assets. Over time, we believe that we can achieve a 55% cost income ratio given that we are a pure retail SME and you can see anyone who is very retail and very SME like examples are there and now their cost income ratio is nothing less than 60% right. So, that is how we are functioning.

Moderator: Thank you, sir. We take the next question from the line of Mr. Ram Kumar from Madhuram Capital. Please go ahead, sir.

Ram Kumar: My first question is on guidance. A few quarters back you have mentioned about doubling the income and profit by 3 to 4 years. So, are we still in line with that? Is there any change on that?

Murali M Natrajan: I want to say that I don't think we have ever given any profit guidance. So, you may want to check what guidance we have given on profit. I don't believe that we give any guidance on profit. Our intention is to double the balance sheet every 3 to 4 years. We are very much on that track is what I would like to believe. The kind of investment we are doing and the kind of investment we have done in frontline without changing any of our strategy in terms of granular retail and SME and Agri portfolio, we believe that we can double our balance sheet.

Ram Kumar: And my second question is on recently Tata Asset Management and DSP planning to double their holding around 9 in DCB Bank. So, do we have any details on when that is going to happen?

Murali M Natrajan: The details have been published on the Stock Exchange and it is public information. What the strategies of these companies are in terms of acquisition, you may have to ask them because we don't have any visibility on their plan on this. Whatever the plan they have exhibit, we have put it on the website.

Moderator: Thank you, sir. We take the next question from the line of Mr. Sameer, an individual investor. Please go ahead, sir.

Sameer: Just one question. Mr. Murali you covered the slowness in the SME, MSME business in this quarter, so thanks for that. So, from the current quarter perspective in Q2 and Q3, do you see it kind of normalizing the disbursements in that area or the two problems that you mentioned about risk weight and the low interest in that portfolio still passes?

Murali M Natrajan: My answer was very specific to TReDS, not SME, MSME. TReDS is part of SME, MSME. Would you like me to explain it in a little bit more detail?

Sameer: Sure.

Murali M Natrajan: So, TReDS is a platform as you know where large companies and medium companies put up their bills, which is basically some kind of material supplied by SMEs to those companies. So, we have recourse to that principal in case the SME does not pay the bill. So, we immediately give the money to the SME with some fee and some interest income and then at the expiry of say 90 days or 120 days depending upon the tenor of the bill, the SME pays. If the SME doesn't pay, the principal has to pay that outstanding. So, it's a very good product for short-term financing for SMEs and it is PSL and we have been very successful in this for the last almost 1.5-2 years. Of course, we use this as a short-term measure to soak up the excess liquidity that we may have. Now, if you find some other avenues for putting our excess liquidity rather than in TReDS where we get a little bit better margin, we do that. We found that for the last 3-4 months, the interest rate that we were expecting based on our cost of fund was not something we were able to command in TReDS. The second problem that was there was there is some clarification, we just need to know as to what are the risk weight of these loans because if it is going to be 100% risk weight, that kind of margin that we are making doesn't make sense because that won't give us the return on equity. So, that is what I explained. We do hope that that will happen, but irrespective of that, our core business in terms of Mortgage, SME, MSME, CC and OD, construction, finance, Agri, co-lending, tractor, all that is all moving pretty much on track.

Moderator: Thank you. We take the next question from the line of Mr. Darpin Shah from Haitong, India. Please go ahead, sir.

Darpin Shah: Sir, I just need the data on collection efficiency on the Slide no. 27. So, if you can just highlight generally what we hear on the ground is that things are significantly better, collection efficiencies are better. But if I look at our numbers on a YoY basis also from June to June, it looks largely similar or slightly lower especially in the home loan part. So, if you can throw some light there?

Murali M Natrajan: You see, if you look at 2 aspects, one is bucket zero. Bucket zero, 99.1 versus 98.6, I wouldn't really lose so much sleep over that, even in business loan you see current 98.3 versus 98.4, yes, I don't see too much of a difference. In home loans, since almost like 100 or 150 crore or something like that portfolio came out of moratorium in April and we had very less number of days. If you see April is the one where you see a lower collection efficiency in home loans at 96.5. I don't see any long-term issue and all, it is basically timing issue. Customers who come out of the moratorium even in the past I have explained. They need few months to kind of get adjusted to this whole thing because we have not paid in the past and not all our portfolio is in

moratorium and all the moratorium will get over by August end, so very little of the moratorium is left, and despite loans coming out of moratorium last year, you can see that there has been very decent performance on slippages and recoveries and upgrades. So, it's more of a giving a little bit more time for this matter and these are all self-occupied property. So, on the ground, the situation as far as I know is very similar. There is nothing alarming in the ground situation. I don't know what other information that you have which you are referring to.

Darpin Shah: So, what I was referring is when we talked to other lenders, they seem to be quite positive in terms of slippages or recoveries and in terms of the..

Murali M Natrajan: Darpin, please show me one bank that has done 100% recovery and upgrade last year. Everyone is very positive. I understand that. But what is the demonstration of the recovery and upgrade? You know, even this quarter, we are at about 62%. This is probably one of the lower ones as compared to what we did last 4 quarters. We are confident of improving it further.

Moderator: Thank you, sir.

Murali M Natrajan: Operator, if there are no questions, then we can wrap up this call.

Moderator: Sure, sir. Ladies and gentlemen, 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 logging in. Again, my apologies for delaying this call. Look forward to talking to you again next quarter. Thank you very much.

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.