View - BUY
CMP : Rs. 39
Target Price: Rs. 55 (In next 12 to 18 mths)

BUSINESS BACKGROUND

Incorporated in 1927, Dhanlaxmi Bank is one of the oldest mid-size private sector banks in India. The bank has a pan-India presence through a network of 260 branches, 371 ATMs covering 680 centers across 15 states. As on March 31, 2017, the bank had total deposits at Rs. 11294 crs with advances at Rs. 6596 crs and an asset base of Rs. 12333 crs. DBL has a well diversified product basket and is present across the Personal Banking, Corporate Banking, NRI Banking, Micro & Agri Banking, SME Banking and other Financial planning verticals. DBL strengths is its number of customers, scale of business, breadth of product offerings, banking experience the bank offers and the trust that customers have in the bank.

INVESTMENT HIGHLIGHTS

Strong Financials for DBL as on FY17 –

DBL reported a positive PAT of Rs 12.38 crs in FY17 after three consecutive years of net losses. Last year the net loss stood at Rs 209.45 crs. The bank also reported a 9% growth in NII totaling Rs 331.60 crs as compared to Rs 304,68 crs last year.

Further the bank reported a healthy improvement in the cost to income ratio which resulted in the operating profits moving up to Rs 96.37 crs as compared to a operating profit of just Rs 3.28 crs last year. The cost to income ratio for DBL has progressively come down to 78.75% in FY17 from 95.68% two years ago. Also other operating parameters like the CASA ratio was also better with higher deposit growth post the de monetization.

On the positive front, demonetization-led growth in CASA helped domestic CASA ratio improve to 29.44% from 25.03% last year and from 24.34% in FY15. Focus segments (Home loans, Retail loans etc.) were up 10-15% YoY whereas consolidation continued in large corporate and SME loans.

**DBL confident on asset quality going ahead –**

DBL is confident that worst of asset quality is behind; and maintaining NIMs appears to be the biggest challenge now, and the bank may not be as adversely affected by recent spike in bond yields.

Asset quality problems also seem to be behind and barring 2-3 accounts, DBL has largely recognized all the stressed loans.

Fresh slippages will be lower than previous quarters while recoveries/upgrades in FY18 are likely to cushion the impact of fresh slippages.
The management sounded wary of margin compression as greater proportion of its loan book gradually transitions to MCLR regime. On loan growth, focus is on domestic market and going direct to customer and the focus of DBL clearly is on retail which accounts for around 44% of its advances portfolio. The other big business component for DBL is the SME and corporate segments which accounted for 25% and 17% of the Asset Advances as on FY17. DBL has also started to offer score base home loans and will do similar offerings on other retail loans.

**Strong liability franchise; margin improvement led by lower CoD –**

DBL has a strong retail presence in south with over 680 customer outlets spread across 260 branches, 371 ATMs and 49 BCs. Of these, 55% branches are in Kerala, followed by 14% in Tamil Nadu, 9% branches in Maharashtra that are CASA rich states and have good industrial activity. The domestic CASA ratio had been stable at 29.44% The NIMs have also 2.76% in FY17 from 2.46% last year. Also GNPA has also reduced to 4.78% in FY17 from a peak level of 7% in FY15 and around 6.36% last year. The NNPA stands at 2.58% as on FY17 as compared to 2.78% last year.

**Loan Book Growth to pick up gradually –**

Loan Book growth is expected to improve going ahead on the back of both retail and corporate loan segments in FY18. The bank management expects a lower teens growth in FY18 from the corporate segment supply chain and retail.

**Govt announces fresh NPA reforms making recovery process stronger for banks –**

The government has also recently amended the Banking Regulation Act (via an ordinance) to give more authority to the Reserve Bank of India (RBI) on resolving banks’ non-performing assets including initiating insolvency proceedings and setting up a committee to advise banks.

This is a positive step as it will enable expeditious resolution of bad loans straining banks’ balance sheets, thus helping to revive credit flow. It also shifts the onus of decision-making from banks to the RBI, in a sense shielding bankers from fears of being investigated later.

Public sector banks will be recapitalised as they take haircuts, but they will have to commit to structural improvements, such as reducing overheads and shutting loss-making branches, in return for capital infusion. The recapitalisation however, may have fiscal implications depending on the actual haircuts taken. The ball is now clearly in the RBI’s court and it will set out the process for resolution.

**DBL Plans to strategise its overall business growth in the following way as stated below –**

**Liability Strategy -**

- DBL plans a systematic growth in deposits
- Additionally its is increasing CASA
- Also DBL’s focus is on increasing Retail / Low cost Deposits

**Asset Strategy -**

- DBL plans to maintain a quality Advance Portfolio
- Increase Retail Advances
- Offer Lending based on Collaterals
- Offer better pricing to customers
NPA Management - Early Resolution of NPA Accounts
Close Monitoring of accounts to avoid slippages
Increased Provision Coverage Ratio

Cost Rationalization -- Relocating high Cost Premises & low hit ATMs
Renegotiating with vendors for cost reduction
Looking at other cost rationalization measures

Focus on Non Interest Income - Continued focus on Cross Selling
Focus on Insurance and Mutual Fund Products
DBL to increase focus on Non Fund based facilities

Other Initiatives -- Leveraging of Technology Products
Transformation Projects
Using effective use of data mining tools
Also adopt improved business visibility measures
Business Outlook & Stock Valuation –

We expect loan growth to improve sharply to 7-10% YoY in FY18E given the change in strategy wherein the bank is also witnessing traction in domestic credit and retail loans.

The DBL management has set in motion several transformational projects including (1) safer lending in corporate segment, (2) CMS and supply chain financing to build SME book, (3) centralized underwriting, pre-approved loans, and building sales infrastructure to boost retail assets and (4) new management on cards for capital market verticals. These transformations will help improve risk-weighted profitability of the business, which should translate into uptick in RoE in the medium term.

The bank is well capitalized with a CAR of 10.26% and believes it will not need any fresh capital for the next 18 months.

Large clean-up over the past few quarters removes the overhang of significant deterioration in asset quality in ensuing quarters. We also like the management’s focus on improving core profitability and risk management practices for sustainable and healthy performance in the ensuing years – results of which are already reflected in Q1FY18 performance.

Currently the DCB stock is trading at 1.18x P/BV on FY18 and 1.05x P/BV FY19 which look attractive from a long term perspective considering the banks size and long term prospects. Another interesting aspect is that the bank could be a prime takeover candidate as presently most funds and HNIs control 47% of the equity and the current management does not have full equity control.

Hence we believe that the DBL stock should be purchased at the current price for a price target of around Rs 55 over the next 12 to 18 months assuming that DCB could get a P/B multiple of 1.5x going ahead.

FINANCIALS

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<th>For the Year Ended March RsCrs</th>
<th>FY15A</th>
<th>FY16A</th>
<th>FY17A</th>
<th>FY18E</th>
<th>FY19E</th>
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<td>Net Interest Income</td>
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<td>655.00</td>
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Source: Company our Estimates
KEY CONCERNS

Slowdown in the economy and decline in loan growth.
Increase in cost to income ratio.
Worsening of asset quality

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