
Brickwork Ratings assigns “BWR A-” for Development Credit Bank’s Subordinate Bonds Issue of INR 1 billion

Issue Rating: BWR A-

Outlook: Stable

Brickwork Ratings has assigned BWR A- (Pronounced BWR A Minus) with ‘stable’ outlook to Development Credit Bank’s (DCB) proposed subordinate bonds issue of Rs 100 crore or INR 1 billion. The Brickwork Rating BWR A- signifies ‘Adequate Safety’. Brickwork has relied upon the audited financials statement and information and clarifications provided by the issuer.

The rating reflects some positive factors like, significant ownership of the promoter, comfortable capital adequacy and leverage, and improving low cost deposits and spread. The rating is partially affected by increasing NPAs, negative net profit, decreasing non-interest income, high operating cost structure, and limited branch network. We understand from our interactions with the bank’s new management team, that they have put in a strategy to address all the current issues.

The meltdown in the international financial market, along with the economic crises in the domestic market, had badly affected Development Credit Bank’s performance, particularly the bank’s asset quality during FY 09. As a result, the bank’s gross and net NPAs have increased to 8.8% and 3.9% respectively in FY09. The increase in non-performing assets was largely due to chasing unsecured retail accounts which resulted in large scale default in unsecured personal loans and a few corporate loans. The bank has since discontinued such aggressive lending and adopted stringent provisioning norms in personal loans portfolio, as a conservative approach.

While the bank’s cost of funds at 8.62% was significantly higher than that of its peers, the bank has shown higher returns at 12.65%. The real estate loans sensitive exposure had been just 5.24%, less than one third of the bank’s peers. Similarly, the bank’s capital market exposure at 1.98% was significantly lower than that of the peers’ average. The bank’s return has been more from the interest income. Non-interest income of the bank has been significantly lower than that of its peers.

The bank’s Tier 1 capital at 11.62% was significantly higher than that of its peers. The total capital however had been less than the peers and the bank needs to supplement its capital to sustain its growth plan envisaged in the current financial year. Brickwork calculates leverage that assess bank’s capital adequacy with reference to both on balance and off balance sheet exposures. DCB has shown a better leverage of 12.88 in FY 09 as compared to 17.63 in FY08.

The bank’s Net Interest Margin (2.80%) was slightly lower than its peers’ average (2.82%) during FY 09. However, the bank had reported negative return on assets (-1.48%) during the year as compared to 1.11% for peer banks. Cost to income ratio was significantly higher than its peers. The bank has been taking steps to improve the cost to income ratio.

DCB branch network has a very high correlation with the distribution of Ismaili community in India. Cities like Mumbai, Hyderabad & Ahmedabad, which have a high

proportion of the Ismaili community have a significantly higher network of DCB branches. If the strategy to access deposits from the Ismaili community is leveraged, DCB has an advantage in terms of generating low cost deposits. During FY 09, the bank's low cost deposits stood at 30.94%, which is 5.16% higher than its peers' average of 25.78%. Its credit-deposit ratio was 176 bps higher than its peers' average of 68.70%

The bank's cost of funds stood at 8.62% as on 31st March 2009, which is significantly (1.75%) higher than its peers' average. Similarly, the return on funds was 340 bps higher than its peers' average of 9.25%.

Brickwork expects the Bank to improve its performance and achieve envisaged growth plan, by prudent lending, avoiding large un-secured exposures and widen its range of products and services to generate uninterrupted income stream. Brickwork expects the revival strategy of the new management team to yield better results in the form of turnaround in the performance in the next one year. The lending focus for Housing and SME's is also a function of economic environment. As such, Brickwork has assigned Stable outlook for the bank's issue.

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Analysts

Dr. A. Suresh Kumar, Lead Analyst
suresh.kumar@brickworkratings.com

Vikas Thakur, Co-Analyst
vikas.t@brickworkratings.com
Phone: 1-860-425-BRIC

Media

Anitha G
media@brickworkratings.com
Phone: 1-860-425-BRIC

Relationship

K N Suvarna, Sr. VP - Business Development
kn.suvarna@brickworkratings.com
Phone: 1-860-425-BRIC