

Rating Rationale for Development Credit Bank's Lower Tier II (subordinated) Debt Issue of INR 65 Crores

Brickwork Ratings (BWR) has reaffirmed the rating of BWR A- (Pronounced BWR A minus) with a stable outlook for the following rating of Development Credit Bank.

Instrument	Amount	Rating	Assigned/ Reaffirmed	Issue Date	Maturity Date	Rating History	
						Review As on	Rating As on
Lower Tier II (subordinated) debt	Rs 65 Cr	BWR A- (Stable Outlook)	Reaffirmed	31 Aug 2009	30 April 2015	BWR A- (Stable) July 2010	BWR A- (Stable) July 2009

The rating "BWR A-" stands for an instrument that is considered to have ADEQUATE degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. The rating has been reaffirmed taking into account the financial performance of the Bank, publicly available information and clarifications sought from the Bank.

The rating, inter alia, factors improvement in asset quality, retail deposits, focus on CASA deposits, increasing profits and comfortable capital adequacy and leverage. The rating is partly affected by limited branch network and pressurized interest margins due to increasing interest rate scenario. However, in May 2011 bank got the approval from RBI to open 10 new branches (6 in metro locations and 4 in semi-urban/rural).

The Bank's performance has continued to improve during FY11. Deposits have increased by 17% and stood at Rs. 5,610 crs in FY11 as against Rs. 4787 crs in FY10. It improved further in Q1FY12 and stood at Rs. 5,980 crs. The bank had reduced dependency on bulk deposits during FY11. DCB has its focus on increasing CASA deposits and on improving the mix of retail term deposits. Retail deposits were at 81.17% of total deposits as on March 31, 2011. CASA deposits increased 16.72% y-y for FY11. CASA ratio as on March 31, 2011 was 35.20% as against 35.40% as on March 31, 2010.

Strong traction on CASA has also helped to maintain NIMs. Net interest margin increased to 3.13% in FY11 as against 2.79% in FY10. The bank's cost of deposits reduced from 6% in FY10 to 5.61% in FY11. However, the cost of borrowings increased from

7.25% in FY10 to 8.12% in FY11. Average yield on interest earning assets also increased to 8.81% in FY11 from 8.51% in FY10. Due to series of rate hikes Bank may see pressure in overall NIM for FY12.

DCB has exhibited substantial progress in de-risking the Balance sheet by replacing unsecured Personal Loans, Commercial Vehicle Loans and Construction Equipment Loans with secured advances (i.e Home Loans, loans against property, loans against term deposits). Total advances grew by 23.50% and stood at Rs. 4,271 crs for FY11 as against Rs. 3,459 crs in FY10. The bank's credit to deposit ratio increased to 76.10% in FY 11 vs 72.30% in FY 10.

DCB has improved its asset quality, though NPA level is still significantly very high. The gross NPA's decreased substantially from 8.69% in FY10 to 5.87% in FY11 and to 5.85% in Q1FY12. The net NPA's also declined substantially from 3.11% in FY10 to 0.97% in FY11. However, there was a slight increase in Net NPA's in Q1FY12 and were 1.19% in Q1FY12.

The bank reported a net profit of Rs. 21 crs in FY11 as against net loss of Rs. 78 crs in FY10. The bank's interest income increased from Rs. 459 crs in FY10 to Rs. 536 crs in FY11, an increase of 16.84%. The net interest expanded in FY11 was Rs. 347 crs as compared to Rs. 317 crs in FY10 (growth by 9.46%). Employee cost as percentage to total cost increased to around 50% in FY11 from 44% in FY10 due to increased recruitment. Net profit in Q1 FY12 is Rs. 8.8 crs compared to a net loss of Rs. 2.9 crs in Q1FY11.

As on March 2011, the bank has reported a capital adequacy ratio of 13.25% as compared to 14.85% in FY10. Tier I capital adequacy ratio stood at 11.10% in FY11 (11.93% in FY10). During FY11, the Bank redeemed subordinated debt of Rs. 46 crs. Currently the bank has the approval for raising Rs. 350 cr of Tier I capital. This is the combination of QIP (not exceeding Rs. 150 cr) and Rights issue (not exceeding Rs. 200 crs). The tier II CAR is at 2.15% and we believe, here bank has some more room to raise Tier II bonds.

DCB got ten more branches licenses in Q1 FY12, six in metro locations and 4 in Semi Urban/ Rural. DCB branch network has a very high correlation with the distribution of Ismaili community in India. The cities like Mumbai, Hyderabad & Ahmadabad, which

have a high proportion of the Ismaili community, have a significantly higher network of DCB branches. As part of strategy the company is trying to access deposits from the Ismaili community.

Rating Outlook:

Rating is sensitive to macro factors where increasing policy rates can affect bank profitability, operational difficulties in ramping up CASA can have significant impact on NIM's. DCB is also prone to management risk as the transformation is the function of current dynamic leadership. As compared to the growth in FY11, Brickwork Ratings expects the performance of the bank to continue to improve during this year. Its focus on improving its asset quality with the help of adequate risk asset coverage, comfortable risk adjusted capital, retention of good people and technology driven banking operations is crucial for bank. Brickwork believes that the revival strategy of the new management team would continue to yield better results.

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