GEMS: Asia India
Banking/Finance Banks

Deutsche Bank

16 April 2007

Development Credit Bank

Reuters: **DCBA.BO** Bloomberg: **DEVB IN** Exchange: **BSE** Ticker: **DCBA**

At an inflection point; initiate with Buy

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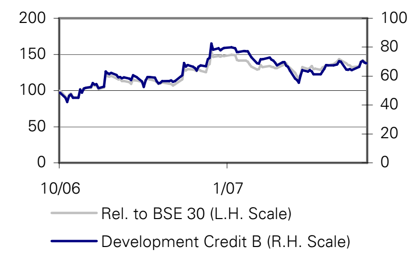
Initiation of Coverage

Buy

Price at 13 Apr 2007 (INR)	**68.95**
Price target - 12mth (INR)	**87.00**
52-week range (INR)	**82.65 - 42.10**
BSE 30	**13,384**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*7.6*	*2.1*	–
BSE 30	*3.1*	*-4.8*	*19.1*

Stock data

Market cap (INRm)	**10,179**
Market cap (USDm)	**239**
Shares outstanding (m)	**111.9**
Major shareholders	**AKFED (30%)**
Free float (%)	**48**

Key indicators (FY1)

ROE (%)	**3.4**
Loan/deposit ratio (%)	**73.8**
Book value/share (INR)	**24.31**
Price/book (x)	**2.9**
NPL/total loans (%)	**10.5**
Net int margin (%)	**2.86**

High-quality turnaround play; initiate coverage with Buy and TP of Rs87

After being in the red for four years, the bank has returned to profitability in 9MFY07. The sustainability of the turnaround is underpinned by a credible revitalization plan of a new, experienced management team that is committed to improving margins, clearing up legacy NPAs and growing the liabilities franchise.

Margin recovery to enhance profitability and consequently RoE

We expect NIMs to improve significantly and reach 3% by FY09E, driven by an increased focus on CASA and a higher pricing power in loans to the self-employed. The bank has already increased its margins by a remarkable 74bps yoy during 9MFY07. Consequently, we expect higher margins to drive the bank's RoE to a more 'normal' 17% by FY09E.

Leveraging synergies with the promoter

The bank has a significant upside on the fee income front as it begins to capitalize on the business relations of the founder. This is likely to help the bank in acquiring and servicing NRI customers in the UK, Africa and the Middle East for a potential remittance-based fee income and up-selling its wealth-management products. We expect fee-to-average-assets to increase by 70bps to 1.64% by FY09E.

Earnings to increase multifold; management attrition the key risk

Our 12M TP of Rs87 is based on a two-stage Gordon Growth model, a baseline deal premium of 27% (average of M&A premiums observed in the Asia-Pac region) and a top-up premium of 5% based on a qualitative attractiveness scorecard. We add the premiums to reflect our belief in the franchise value. The expected earnings inflection makes the current 'high' valuations not meaningful. The stock is hardly covered by the street, and a foreign ownership headroom exists. The key risk is attrition in management ranks.

Forecasts and ratios

Year End Mar 31	2005A	2006A	**2007E**	2008E	2009E
Provisioning (INRm)	375.5	574.7	**186.7**	214.8	299.4
Pre-prov profit (INRm)	-307.6	-247.1	**275.2**	707.8	1,442.4
Net profit (INRm)	-683.1	-852.6	**88.5**	493.0	1,143.0
EPS (INR)	-10.44	-12.04	**0.79**	3.05	6.50
EPS growth (%)	13.0	15.3	**–**	285.6	113.3
PER (x)	–	–	**87.2**	22.6	10.6
Price/book (x)	–	–	**2.88**	1.91	1.62
DPS (net) (INR)	0.00	0.00	**0.00**	0.00	0.00
Yield (net) (%)	–	–	**0.0**	0.0	0.0

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated:12 April 2007

Running the Numbers

Asia Pacific

India

Diversified Banks

Development Credit Bank

Reuters Code DCBA.BO

Buy

Price as of 13 April	INR 68.95
Price Target	INR 87.00
Web Site	http://www.dcbl.com

Company Description

Development Credit Bank is a new generation private sector bank with an asset base of US$1bn. The operations of the bank encompass three primary business lines: consumer banking, commercial banking and treasury operations. The bank typically targets self-employed business individuals as its target segments. Post DCB's $41mn IPO in October 2006, Aga Khan Fund for Economic Development (AKFED) which is the promoter of the bank reduced its stake from 58% to 31%. The bank further has plans for a INR2.25bn QIB post which AKFED's stake would reduce to less than 26%.The bank has a network of 72 state-of-the-art branches with around 40% of them in Mumbai. The bank recently revamped its entire management and has embarked on an aggressive revitalization plan to reduce its NPA levels, focus on CASA and improve margins.

Research Team

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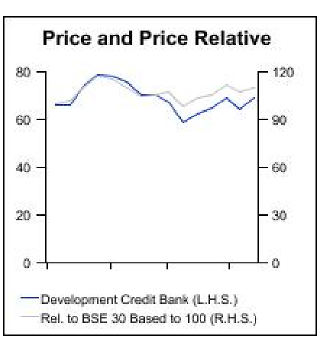
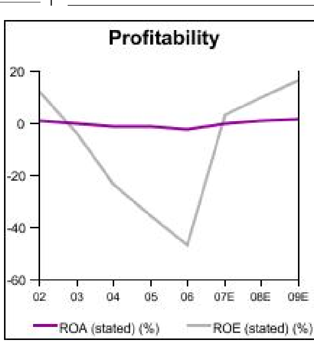
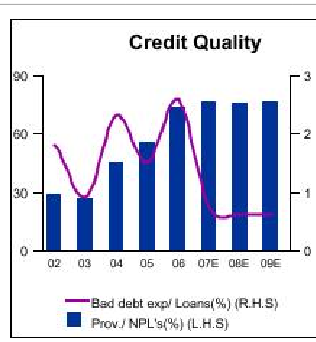
Absolute Price Return	1m	3m	12m
	8.9%	2.1%	NaN%
52-week Range	INR 42.10 - 82.65		
Market Cap	INR 10,179 m		
	USD 239 m		

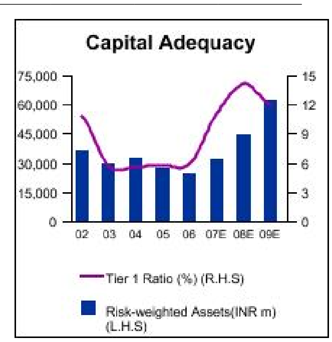
Company Identifiers	
Bloomberg	DEVB IN
Cusip	–
SEDOL	B0ZJXW4

Y/E 31 March	2002	2003	2004	2005	2006	2007E	2008E	2009E
Data Per Share								
EPS (stated) (INR)	15.88	-3.83	-9.24	-10.44	-12.04	0.79	3.05	6.50
EPS FD (stated) (INR)	15.88	-3.47	-6.61	-10.43	-11.20	0.60	2.81	6.50
EPS FD (DB adj.) (INR)	15.88	-3.47	-6.61	-10.43	-11.20	0.60	2.81	6.50
Growth rate - EPS (stated) (%)	NM	-124.1	141.4	13.0	15.3	–	285.6	113.3
DPS (INR)	3.00	2.61	0.67	0.00	0.00	0.00	0.00	0.00
BVPS (stated) (INR)	136.31	66.05	28.74	30.45	21.57	24.31	36.02	42.53
BVPS (DB adj.) (INR)	69.89	-16.15	-0.25	9.57	10.54	19.49	31.45	37.73
Average market cap (INRm)	0	0	0	0	0	10,179	10,179	10,179
Shares in Issue (m)	23	28	65	65	76	148	176	176
Valuation Ratios & Profitability Measures								
P/E (stated)	–	–	–	–	–	87.2	22.6	10.6
P/E FD (stated)	–	–	–	–	–	115.0	24.6	10.6
P/E FD (DB adj.)	–	NM	NM	NM	NM	115.0	24.6	10.6
P/B (stated)	–	–	–	–	–	2.88	1.91	1.62
P/B (DB adj.)	–	–	–	–	–	3.54	2.19	1.83
ROE (stated) (%)	12.2	-3.9	-23.1	-35.3	-46.9	3.4	9.9	16.6
ROA (stated) (%)	0.90	-0.23	-0.90	-1.38	-2.03	0.21	0.86	1.46
Dividend yield(%)	–	–	–	–	–	0.00	0.00	0.00
Dividend cover(x)	5.29	-1.47	-13.81	NM	NM	NM	NM	NM
Payout ratio (%)	18.9	-75.1	-10.1	0.0	0.0	0.0	0.0	0.0
Profit & Loss (INRm)								
Net interest revenue	895	706	964	697	752	1,128	1,527	2,164
Non interest income	931	466	479	709	787	1,139	1,516	2,038
Fees & Commissions	234	288	293	369	395	612	888	1,287
Trading Revenue	579	78	-1	52	229	318	362	410
Insurance revenue	0	0	0	0	0	0	0	0
Dividend income	0	0	0	0	0	0	0	0
Other revenue	118	100	187	288	163	209	267	341
Total revenue	1,826	1,172	1,443	1,406	1,539	2,267	3,043	4,201
Total operating costs	803	1,093	1,357	1,713	1,786	1,992	2,336	2,759
Pre-provision profit/(loss)	1,023	80	86	-308	-247	275	708	1,442
Bad debt expense	398	222	606	376	575	187	215	299
Operating Profit	625	-142	-520	-683	-822	88	493	1,143
Goodwill	0	0	0	0	0	0	0	0
Pre-tax associates	0	0	0	0	0	0	0	0
Extraordinary & Other Items	0	0	0	0	0	0	0	0
Pre-tax profit	625	-142	-520	-683	-822	88	493	1,143
Tax	260	-44	-88	0	31	0	0	0
Minorities	0	0	0	0	0	0	0	0
Preference dividends	0	0	0	0	0	0	0	0
Stated net profit	365	-98	-432	-683	-853	88	493	1,143
DB adj. core earnings	365	-98	-432	-683	-853	88	493	1,143
Key Balance Sheet Items (INRm) & Capital Ratios								
Risk-weighted assets	36,294	29,718	32,718	27,727	24,168	32,217	44,604	62,385
Interest-earning assets	27,260	40,659	49,382	43,171	34,402	44,393	60,658	84,021
Total loans	23,189	25,527	26,665	23,300	20,982	29,194	39,931	55,133
Total deposits	36,918	36,571	44,742	38,948	31,240	39,536	55,095	76,834
Stated shareholders equity	3,131	1,859	1,878	1,994	1,642	3,589	6,330	7,473
Preference share capital	–	–	–	–	–	–	–	–
Tier 1 capital	3,128	1,754	1,779	1,842	1,642	3,589	6,330	7,473
Tier 1 ratio (%)	10.87	5.68	5.66	5.85	5.96	11.14	14.19	11.98
Tangible equity/ total assets (%)	7.50	4.27	3.56	4.28	4.39	7.46	9.49	8.28
Credit Quality								
Gross NPLs / Total loans (%)	9.29	12.38	12.97	13.34	15.01	10.47	8.30	6.54
Provisions / NPLs (%)	29.18	26.76	45.22	55.98	73.33	76.72	75.76	76.59
Bad debt exp/ Avg loans (%)	1.81	0.91	2.32	1.50	2.60	0.74	0.62	0.63
Growth Rates & Key Ratios								
Growth in net interest income (%)	NM	-21.0	36.5	-27.7	7.9	50.0	35.4	41.7
Growth in fee income (%)	–	22.8	1.9	25.7	7.1	55.0	45.0	45.0
Growth in non-interest income (%)	–	-50.0	2.8	48.0	11.1	44.7	33.1	34.4
Growth in revenues (%)	NM	-35.8	23.1	-2.6	9.5	47.3	34.2	38.1
Growth in costs (%)	NM	36.1	24.2	26.2	4.3	11.5	17.3	18.1
Pre-provision earnings growth (%)	–	-92.2	7.9	-458.5	-19.7	-211.4	157.2	103.8
Growth in bad debts (%)	NM	-44.4	173.5	-38.0	53.0	-67.5	15.0	39.4
Growth in RWA (%)	NM	-18.1	10.1	-15.3	-12.8	33.3	38.4	39.9
Growth in loans (%)	–	10.1	4.5	-12.6	-9.9	39.1	36.8	38.1
Growth in deposits (%)	–	-0.9	22.3	-13.0	-19.8	26.6	39.4	39.5
Loan-to-deposits ratio (%)	62.8	69.8	59.6	59.8	67.2	73.8	72.5	71.8
Net int. margin (%)	3.45	2.08	2.14	1.51	1.82	2.86	2.91	2.99
Cost income ratio (%)	44.0	93.2	94.1	121.9	116.1	87.9	76.7	65.7
Cost asset ratio (%)	2.0	2.6	2.8	3.4	4.3	4.7	4.1	3.5
Trading income/ Total Rev (%)	31.7	6.6	-0.1	3.7	14.9	14.0	11.9	9.8









Source: Deutsche Bank AG estimates, company data

Investment thesis

Outlook

New management team at the forefront of a turnaround story

We believe DCB is a high-quality turnaround play that is poised to show multifold increase in earnings growth and, consequently, a significant improvement in RoE in the next three years. We expect earnings to grow at a CAGR of 187% over the same period and RoE to reach 16.5% by FY09E. The bank, having incurred losses for the past four years, has now returned to profitability in 9MFY07. At the forefront of this turnaround is a new management team with an excellent execution track record; it has now embarked on a threefold revitalization plan to improve margins, focus on reducing NPAs and build up the liabilities franchise.

The most remarkable achievement of this year-old management team is a significant 74bps yoy improvement in margins to 2.45%. We expect margins to improve to 3% by FY09E, driven by an increased focus on low-cost deposits and a higher pricing power in the loans to self-employed people. Consequently, we expect margins to drive the bank's RoE to 17% by FY09E.

Capitalizing the promoter's business relations should help it in acquiring NRI business

The bank has significant upside on the fee income front as it begins to capitalize on the business relations of the promoter. This is likely to help the bank in acquiring and servicing NRI customers in the UK, Africa and the Middle East for a potential remittance-based fee income and also cross-sell its wealth-management products. The bank has already started using its branch network to generate fee income through a third-party distribution of mutual funds and insurance policies. We expect that fees-to-average-assets will increase by 70bps to 1.64% by FY09E.

Valuation

We believe the conventional single-stage Gordon Growth model doesn't capture the high growth that the bank is likely to enjoy for quite some time, and hence we have used a two-stage P/BV Gordon Growth model. Based on this model, we arrive at a fair P/BV of 1.54x on a normalized RoE of 16.45%. This results in a core business value of Rs58.9. Our other assumptions are: a risk-free rate of 9.8% (DB estimate for India), a risk premium of 4.4%, a beta of 1.2 (Bloomberg), a 30% growth rate for the first ten years, a 4% perpetual growth rate, a 10% payout ratio for the first ten years, and a 25% perpetual payout.

We also factor in a deal premium of 27%, which is the average of the deal premiums observed for M&A transactions across the Asia-Pac region. We top it up with an additional premium of 5% based on an attractiveness scorecard, building in factors such as ease of consolidation and liabilities franchise. Finally, we arrive at a target price of Rs87.

Risks

The key risk for DCB is related to its management and any attrition at the top layers given that the entire turnaround story heavily depends on smooth execution. Though management has been able to improve Gross NPLs, we believe any incremental slippages or deterioration of asset quality could be detrimental to the stock performance.

Margins to recover

Strong rebound in margins expected

The bank has been able to significantly improve its margins by 74bps to 2.47% in 3QFY07 by focusing on CASA and high-yielding segments like personal loans. Retail advances now form 34% of the total lending compared to 26% a year ago. Personal loans constitute around 60% (of which 59% is unsecured) of the total retail portfolio and the bank is increasingly focusing on self-employed individuals where it is enjoying significant pricing power. We expect the bank to improve its margins to 3% by FY09E.

Figure 1: Enjoying significant pricing power

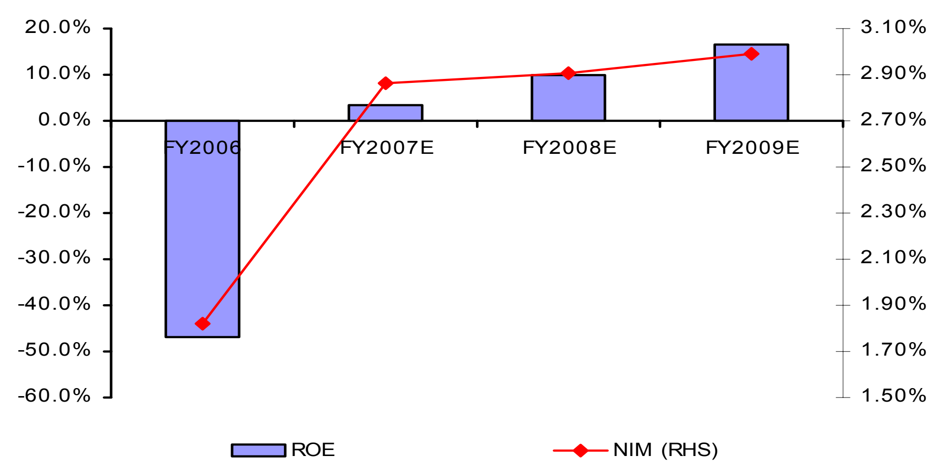
Margin Components	3QFY06	3QFY07	Change (bps)
Yield on advances	**8.25%**	**9.62%**	**137**
Yield on Retail Advances	**11.95%**	**12.54%**	**59**
Yield on Corporate Advances	6.93%	8.12%	119
Yield on personal loans	16.00%	17.40%	140
Yield on investment	6.40%	8.02%	162
Cost of funds	5.46%	5.73%	27
NIM	**1.71%**	**2.45%**	**74**

Source: Company data, Deutsche Bank

Consequently an improvement in RoE…

We expect the RoE to expand to 16.6% driven by a rise in NIMs as well as fee income. After factoring in a QIP issuance of Rs2.25bn, the F2009E Tier-1 would still be at 10.9%, which leaves enough room for leveraging and improving the RoE.

Figure 2: DCB – Margins to drive RoE



Source: Company data, Deutsche Bank

Fee income to rise rapidly

Leveraging synergies with the promoter

Bank's association with AKFED should help it get vital NRI business

The bank's promoter Aga Khan Fund for Economic Development (AKFED) is an international development agency which promotes entrepreneurship in the private sector in specific regions of the developing world. AKFED promotes private sector initiative and entrepreneurship through equity investment in partnerships with multilateral agencies, international investors, local development institutions and individuals. AKFED operates in five broad sectors: industry and infrastructure, tourism development, financial services, media, and aviation. We believe that the bank's association with the promoter will help it in attracting talent. The bank has an opportunity to build on its expertise and capitalize on the business relations of the promoter with other banks. This will help the bank in acquiring and servicing NRI customers in the UK, East Africa and the Middle East. As a result, we expect that the bank will: (i) earn a fee-based income from potential remittance-related transactions, and (ii) up-sell wealth-management products to the NRI base.

Leveraging other business alliances

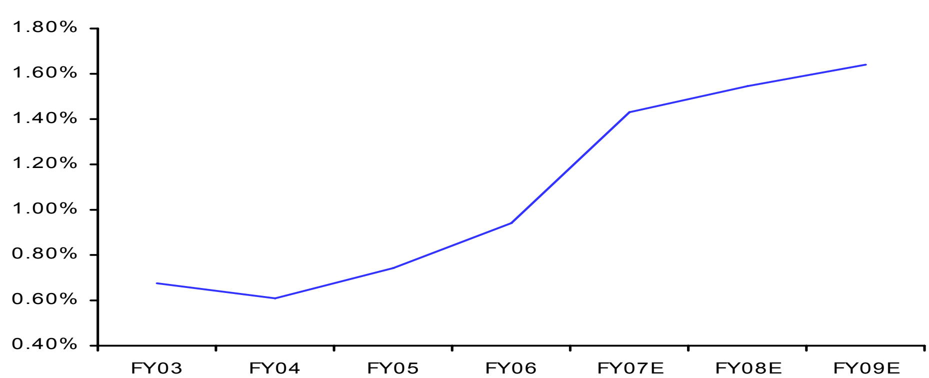
New businesses and alliances to help enhance fee-based income and service offering, and increase product portfolio

The bank intends to enhance its fee-based income by entering into new businesses and alliances. This will also help the bank in increasing the product portfolio offered to its customers and enhancing its service offerings. The bank has entered into lines of business such as distribution of life insurance and mutual fund products. The bank has entered into an alliance with Birla Sun Life Insurance Company Limited to distribute life insurance and with Bajaj Allianz General Insurance Company Limited to distribute general insurance products. It has also built on alliances to distribute mutual funds for various fund management companies.

Fee to average assets to improve by 70bps in three years

We expect that fees to average assets for DCB will improve by 70bps in the next three years. We believe DCB has the requisite technological platform to leverage and cross-sell products to generate fee income. We believe that fee income through third-party distribution is a significant contributor to the overall fee income growth of the bank.

Figure 3: DCB – Fee to average assets to improve significantly and drive profitability



Source: Company data, Deutsche Bank

Top-quality management

Experienced management team with excellent execution track record

The bank completely revamped its management by bringing in a new and experienced team with an excellent execution track record. The key to DCB's revitalization plan would be sound execution, which we believe is a function of the quality of management.

Figure 4: Key management personnel

Name	Designation	Prior Experience
Mr Nasser Munjee	Non Executive Chairman	Ex- MD & CEO of IDFC, Ex-Executive Director of HDFC
Mr. Gautam Vir	MD & CEO	25 years of banking experience across India, Asia Pacific, Middle East and Eastern Europe. He has worked with Bank of America, Citibank N.A., Standard Chartered Bank. Last position held was CEO – Hebros Bank, Sofia, Bulgaria, from 2000 to 2005
Mr. Adil Kasad	Chief Financial Officer	20 years of experience in companies like A.F. Ferguson, Tatas, Accenture India, Countrywide Financial
Mr. R Venkattesh	Head- Human Capital	15 years of work experience in the area of human resource management. Last position held, Human Resource – Countries – Standard Chartered Bank
Mr. Pravin Batra	Head - Corporate & Business Banking	17 yrs of experience in Citibank NA, Sr. V.P. Corporate Banking IndusInd Bank
Mr. P. N. Vasudevan	Head - Consumer Banking Group	19 years of experience with Cholamandlam Investment & Finance Co. Ltd. Last position held: V.P. – Financial Services Group
Mr. Harihar Krishnamoorthy	Head – Treasury & Financial Institutions	22 years of banking experience in Standard Chartered Bank, COMMERZBANK
Mr. Parag Patankar	Chief Operation & Technology Officer	13 years of experience in ICICI Bank and ICICI, Sr. V.P. Retail Technology Group 3i, Director, CIO & Business Head – Apnaloan.com
Mr. Susheel Narain Kak	Chief Credit & Risk Officer	Over 30 years' banking experience in State Bank of India, Deutsche Bank AG, and IDBI Bank
Mr. D K Vasal	Head - Legal & Compliance	10 years of experience in the legal department of Times Bank & Standard Chartered Bank, Head Legal Counsel – Vedanta Resources Plc.

Source: Company data, Deutsche Bank

ESOPs to retain talent

A fairly high vesting period should offset risk of attrition

The bank has given ESOPs to the top and middle layers of management and these ESOPs have an average vesting period of four years. Hence we believe that the issue of attrition is not too significant given a fairly high vesting period. On an average (excl the MD), the options are "In the Money" by Rs12mn. For Gautam Vir, who is the MD, options are "In the Money" by Rs102mn.

Figure 5: ESOPs of DCB management's currently " In the Money" (Rs m)

Management Personnel	Designation	ESOPs value at CMP	ESOPs/Annual Sal	In the Money
Gautam Vir	Managing Director	101.06	9.4x	65.45
K Harihar	Head - Treasury	13.61	1.6x	8.82
D K Vasal	Head - Legal & Compliance	9.96	2.1x	6.45
R Venkattesh	Head - Human Capital	8.30	2.0x	5.38
Pravin Batra	Head - Corporate & Business Banking	15.60	0.6x	10.11
Parag Patankar	Chief Operations and Technology officer	13.61	1.5x	8.82
P.N Vasudevan	Head - Consumer Banking	11.62	3.0x	7.53
Adil Kasad	CFO	9.96	NA	6.45
Susheel Narain Karnik	Chief Credit and Risk Officer	9.96	NA	6.45

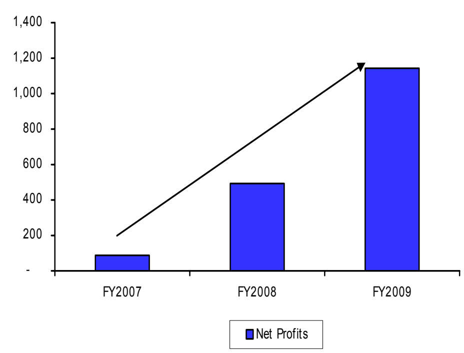
Source: Company data, Deutsche Bank Note:

Financials and valuations

Strong 187% CAGR in EPS growth for FY07-FY09E

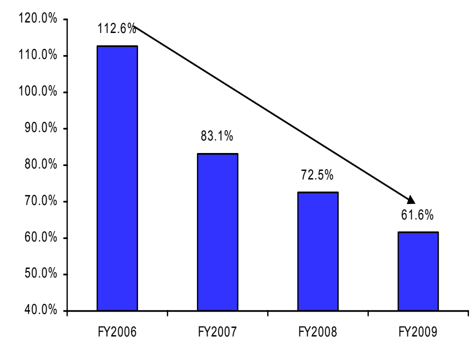
We expect the bank to post a strong earnings growth of 187% for the next two years driven by a robust NII and fee income growth. We expect the cost-income ratio to stabilize around 62% by FY09E as the employee and branch strength are leveraged to achieving higher growth and profitability.

Figure 6: Profitability to improve



Source: Deutsche Bank Note: Net profit figure is in Rs mn

Figure 7: Declining C/I ratio



Source: Deutsche Bank

Premium valuations to capture high growth

We believe the conventional single-stage Gordon Growth model doesn't capture the high growth that the bank is likely to enjoy for quite some time and, hence, we have used a two-stage P/BV Gordon Growth model.

The two-stage Gordon Growth model for calculating the fair P/BV can be represented by the following:

$$P/BV = RoE * \{(p(1+g) * (1- (1+g)^n/(1+r)^n)) + (p_n(1+g)^n(1+g_n))/((r-g_n)(1+r)^n)\}$$

Where g = growth rate for the first n (high growth) years

p = payout ratio in the first n years

g_n = perpetual growth rate

p_n = perpetual payout ratio

RoE = normalized/sustainable RoE

P/BV = price-to-book ratio

Figure 8: DCB – Sustainable RoE

	Normalized	Remarks	FY08E	FY09E
Net interest income/ avg. total assets	3.00%	Expect to normalize at 3%. We believe this is in line with other retail-focused banks. DCB is targeting 50% retail mix by FY09E	2.66%	2.76%
Non-interest income/ avg. total assets	1.90%		2.69%	2.64%
Total income/ avg. total assets	4.90%		5.35%	5.40%
Operating expenses/ avg. total assets	2.00%		3.88%	3.32%
Operating profit/ avg. total assets	2.90%		1.47%	2.08%
Provisions/ Avg. total assets	1.30%	Higher provisions assumed due to higher portion of unsecured lending and clean-up required for the legacy NPAs	0.61%	0.62%
(1 - tax rate)	67.00%	Nominal tax rate though the bank doesn't have to pay taxes till FY09	100.00%	100.00%
Return on avg. total assets	1.07%		0.86%	1.46%
Avg. total assets/ average equity (x)	15.5x	Higher leverage possible because of sound capital position by FY09E	11.6x	11.4x
Return on equity	16.45%		9.94%	16.56%

Source: Deutsche Bank

Using the above formula, we arrive at a fair P/BV of 1.54x on a normalized RoE of 16.5%. This results in a core business value of Rs65.6/share.

We believe that over and above the core business value, DCB ought to be given a premium based on the value of the franchise over its currently run business. We thus first factor in a deal premium of 27% which is the average of the deal premiums observed for M&A transactions across the Asia-Pac region.

Figure 9: Deal premiums for actual bank deals over the last 4 years

Target Name	Acquirer Name	Deal Premium
H&CB	Kookmin Bank	0.2%
Overseas Union Bank	United Overseas Bank Ltd	26.8%
DBS Bank Hong Kong	DBS Group Holdings Ltd	61.4%
Taipeibank	Fubon Financial Holding Co	46.0%
Chohung Bank	Shinhan Financial Group Ltd	7.0%
Chohung Bank	Shinhan Financial Group Ltd	22.1%
Chohung Bank	Shinhan Financial Group Ltd	5.2%
Ufj Holdings Inc	Mitsubishi UFJ Financial	35.8%
Bank Nisp Pt	Oversea-Chinese Banking Corp	5.1%
Prudential Bank	Bank Of Philippine Islands	95.6%
Equitable PCI Bank	Banco De Oro Universal Bank	15.2%
Bank Buana Indonesia	United Overseas Bank Ltd	0.9%
Farmers Bank Of China	Taiwan Cooperative Bank	5.3%
Momiji Holdings Inc	Yamaguchi Bank Ltd	-28.2%
Southern Bank Berhad	Bumiputra-Commerce Hldgs	6.8%
Average		**21%**
Centurion Bank	Bank of Punjab	4.6%
ICICI Bank	Bank of Madura	100.0%
HDFC Bank	Times Bank	8.1%
IDBI	United Western Bank	21.0%
Average		**33%**
Combined average		**27%**

Source: Bloomberg, Deutsche Bank

We top it up with an additional premium of 5%, which is reflective of the qualitative factors like high-quality deposit franchise, ease of consolidation, superior technological platform and product mix as shown in the following score card (Figure 10). This is proprietary and not an industry standard. The highest score in any category is 5 and the lowest 1.

Figure 10: Justification for additional premium

Parameters	Scores	Remarks
No of Branches	2	More branches imply larger network and hence more scalability
Deposit Franchise	3	Predominantly CASA mix
Geographical Location	3	Pan-India presence, more weight for richer regions like Punjab
Technology	4	Core Banking, Extent to which IT platform is leveraged
Ease of consolidation	5	Existence of ESOPs, concentration of shareholding
Asset quality	2	Gross NPAs at 2009
Product mix/suite	4	Ability to generate fee income, higher margin/RoE products
Total Score	**23**	

Attributed premiums:

Total score	Premium
0-20	0%
21-25	5%
26-30	10%
30+	15%

Source: Deutsche Bank

We have assigned a low premium/score to DCB because of its smaller branch network and concentrated presence. Though asset quality is expected to consistently improve, we still expect Gross NPAs to hover around 6.5% by FY09E as a result of which the acquirer would still have some cleaning up left to do after the acquisition. Finally, after incorporating the M&A premium and the top-up premium, we arrive at a 12M target price of Rs87.

Figure 11: Target price calculation methodology

Initial no of years	**10**
Growth rate for the first 5 years	30%
Pay out ratio for the first 5 years	10%
Perpetual growth rate	4.0%
Perpetual payout ratio	25%
Cost of Equity	15.5%
Target Price–to-Book Ratio (Two-stage model)	
Component A	2.03
Component B	7.35
Fair P/BV (Based on 14.8% Normalized RoE)	**1.54**
Core Business Value (Rs)	**65.6**
Deal Premium	
Indian Banks	33%
Asia Pacific Banks	21%
Average Premium	**27%**
Additional Premium based on Score Card	
(Qualitative Factors)	
Score – 23	5%
Target Price (Rs)	**87**

Source: Deutsche Bank

Based on our 12M target price of Rs87, the bank is expected to trade at 2.75x FY08E ABV vs. the current trading value of ~2.2x FY08E ABV. We believe the bank deserves to trade at premium valuations due to the following reasons:

- A combination of high earnings growth and rapidly improving RoE. The RoE is expected to improve from 3.4% in FY07E to 16.6% in FY09E
- Possibility of re-rating since the FII limit is still open. The foreign shareholding is currently at 64%, which gives some headroom for FIIs to buy (maximum 74%)
- Improvement in asset quality as it begins to record increasing recoveries.

Risks

Management attrition

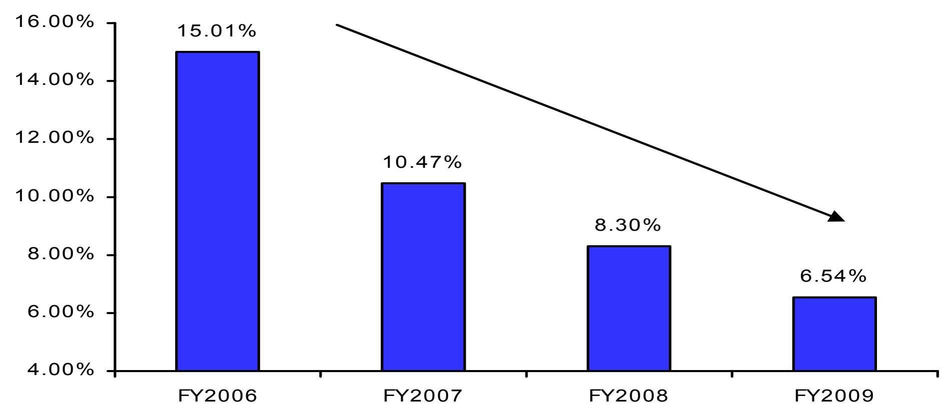
The key risk for DCB is related to its new management team and any attrition at the top layers given that the entire turnaround story heavily depends on smooth execution. However, given the structure of compensation and other benefits like ESOPs (with an average vesting period of four years) provided to management, we believe that attrition is unlikely.

Deterioration in asset quality

Recurring write-offs could affect stock performance in the interim

Though management has been able to improve Gross NPLs, we believe any incremental slippages or deterioration of asset quality will be detrimental to the stock performance. Management plans to write off Rs1bn after the QIP issuance of Rs2.25bn, but some shareholders have objected to this move as a result of which a case is pending in the court. Though we haven't factored in any large write-offs in our estimates, we believe recurring write-offs could affect stock performance in the interim. Further, there is risk of some hidden NPLs resurfacing, which were not detected or accounted for during the tenure of the earlier management.

Figure 12: DCB – Gross NPAs, though declining, are still high



Source: Company data, Deutsche Bank

Company background

Brief description

Typically targets self-employed business individuals

Development Credit Bank is a new-generation private sector bank with an asset base of US$1bn. The operations of the bank encompass three primary business lines: consumer banking, commercial banking and treasury operations. The bank typically targets self-employed business individuals as its target segment. After DCB's US$41mn IPO in October 2006, AKFED, the promoter of the bank, reduced its stake from 58% to 31%. Further, the bank has plans for a INR2.25bn QIB after which AKFED's stake would reduce to less than 26%.The bank has a network of 72 state-of-the-art branches with around 40% of them in Mumbai. The bank plans to take this number to 100 by 2008. The bank recently revamped its entire management and has embarked on an aggressive revitalization plan to reduce its NPA levels, focus on CASA and improve margins. It currently has around 0.65mn customers.

Important milestones

Figure 13: Key milestones

Period	Key Events
1995	Development Co-operative Bank Limited was converted into Development Credit Bank Limited. The shares were acquired by the then promoter, Aga Khan Fund for Economic Development
2002	The bank launched mobile banking with both push and pull options
2003	The bank received awards from Birla Sunlife for excellence in distributing financial products
2004	The bank was classified as "new private sector bank" by RBI
2006	The bank attracted private equity capital by HDFC Limited, Khattar Holdings Pte. Ltd. and Amtel Finance Limited at the price of Rs45 in Feb 2006. This comprised 14.21% of the total share capital. This move helped the bank to restore its capital adequacy and prepare for its IPO
2006	The bank raised Rs1.86bn in its IPO which was a huge success, It was over-subscribed more than 35 times

Source: Company data, Deutsche Bank

DCB's revitalization plan

Raising capital

Management has pursued new capital infusions from private investors since constraints on the bank's capital have restricted its ability to grow its business. In February 2006, the Bank issued 15.18 % of its equity share capital for Rs520mn to the Private Equity Investors. It came out with its US$41mn IPO in Oct 2006 and now plans a Rs2.25bn QIP by June 07.

Improve asset quality through prudent risk management

The bank has improved its loan and investment portfolios by carefully targeting the customer base and implementing a comprehensive risk-assessment process and diligent risk-monitoring and remediation procedures. Additionally, it actively monitors loans and reassess their credit ratings once a year or more frequently if they are at risk. The bank also implemented aggressive remediation policies to recover non-performing loans. Since 2003, its incremental net impaired loan assets have been 0.75% of the total net incremental loans approved.

Address the legacy of historically high NPA levels

The bank has had a legacy of high-level NPAs and has adopted a conservative policy in actively recognizing these NPAs, providing for them in its accounts and otherwise managing the NPA exposure. It has taken provisions with respect to NPAs of Rs606mn, Rs418mn and Rs545mn in each of FY04, FY05 and FY06 respectively. After provisioning, the bank's net non-performing assets were worth Rs840mn as of FY06, representing 4.5% of net advances. As of 3QFY07, net NPAs were at 2.78% whereas Gross NPAs have been reduced from 15% (FY06) to 12.6% as of 3QFY07.

Lowering cost of funding

The bank's main focus will remain on growing CASA to further lower the cost of funds and grow term deposits to facilitate the creation of liquidity to fund balance sheet growth. Since the formal launch of consumer banking, the bank has reduced its cost of funds from 8.09% as at March 2003 to 5.47% as at March 2006. The cost of funds as of 3QFY07 has increased to 5.73% but we believe this is in line with the overall market trends as interest rates have moved up quite significantly since March 2006. The CASA ratio stood at 32% as of 3QFY07 and management targets a CASA of 40% by FY09E.

Reducing operating expenses

The bank has taken strong measures to reduce staff costs and non-strategic operating costs. It introduced a voluntary retirement scheme in 2005 and has a rigorous programme to identify and reduce non-strategic costs. The financial benefits of these measures are already being recognized, and these cost-saving initiatives will continue as the business grows.

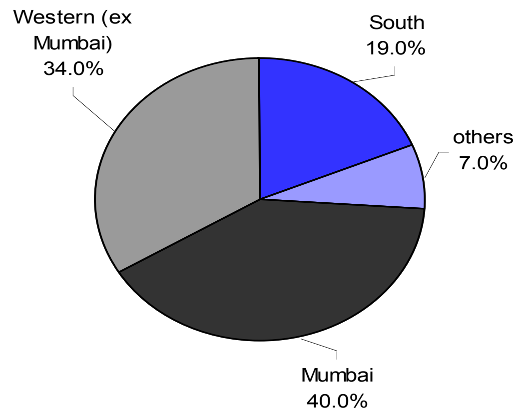
Focusing on core business

The bank intends to maintain its position as a customer-focused institution that provides comprehensive banking and related services in its core consumer banking, commercial banking, and treasury businesses.

Geographical presence

The bank has 72 branches with 40% of them in Mumbai. It has applied for 16 new branch licenses with the RBI and is waiting for its approval. The bank is targeting an expansion of its network to 100 by FY08 and 120 by FY09.

Figure 14: DCB – Geographical spread of branch network

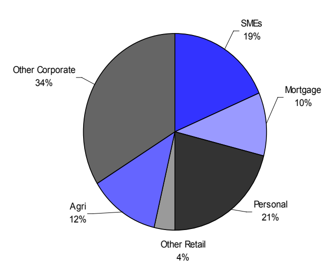


Source: Company data, Deutsche Bank

Business mix

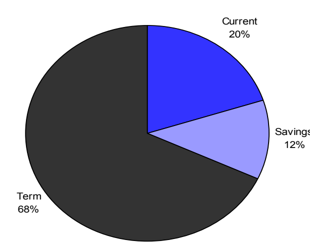
Currently, DCB's portfolio consists of both retail and corporate loans. The corporate loans constitute more than 50% of the loan portfolio, while the retail segment contributes about 34% of the loan mix. Around 60% of the retail portfolio is comprised of personal loans, especially to self-employed people. The bank plans to increase its retail exposure to 50% in the next two years. The bank has around 32% in low-cost deposits (Current and Savings deposits) with the balance being term deposits. The bank plans to take its CASA ratio to 40% by FY09.

Figure 15: DCB – Loan mix



Source: Company data, Deutsche Bank

Figure 16: DCB – Deposit mix



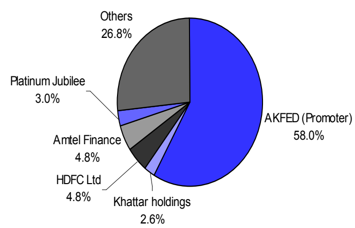
Source: Company data, Deutsche Bank

Shareholding pattern

Further scope of increasing FII stake

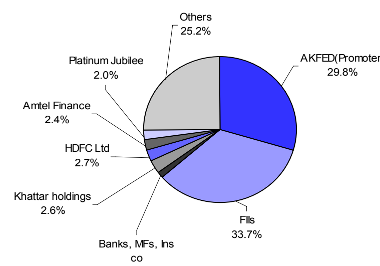
Currently, the total foreign shareholding (including the promoter) at DCB is at 64%. The board recently approved the increase of the FII limit from 24% to 49%. Consequently, it also received RBI approval and, currently, FIIs hold a c28% stake in the bank. Therefore, it has a comfortable cushion to increase it further. The shareholding of the promoter of the bank, i.e. AKFED, was reduced to 30% after the IPO from the 58% before it. The bank plans to bring down the promoter holding to less than 26% by June 2007 through a QIP issue of Rs2.25bn, which has already received shareholder approval.

Figure 17: Shareholding pattern (Pre IPO)



Source: Company data, Deutsche Bank

Figure 18: Shareholding pattern (Dec'06)



Source: BSE< Company data, Deutsche Bank

Figure 19: DCB – Foreign shareholding (Dec'06)

Foreign Shareholding	% Holding
AKFED	29.8%
Amtel Finance	2.4%
Khattar Holdings	2.6%
NRI	0.5%
FIIs	28.2%
Total Foreign holding	**63.5%**

Source: BSE, Company data, Deutsche Bank

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Development Credit Bank	DCBA.BO	68.95 (INR) 13 Apr 07	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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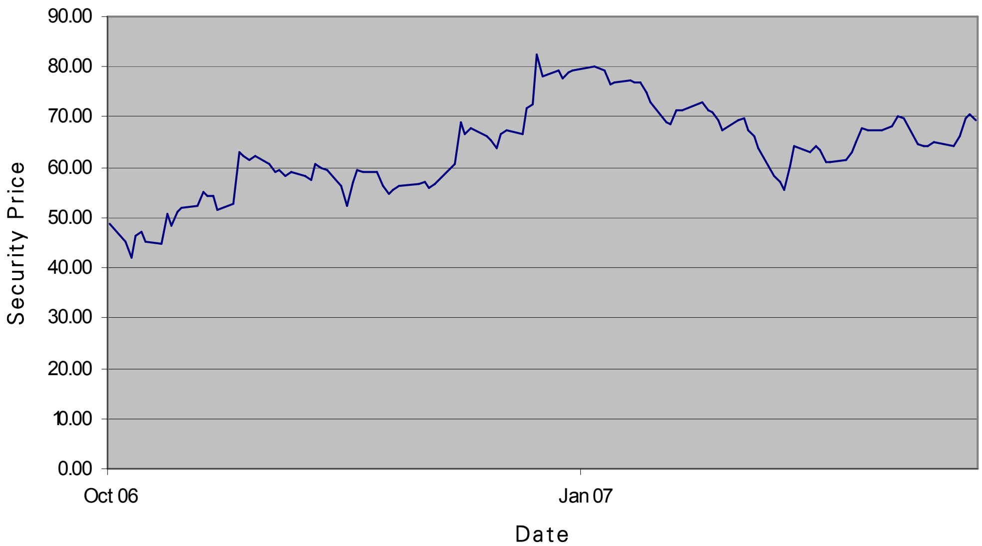
Historical recommendations and target price: Development Credit Bank (DCBA.BO)

(as of 4/13/2007)



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Strong Buy
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Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
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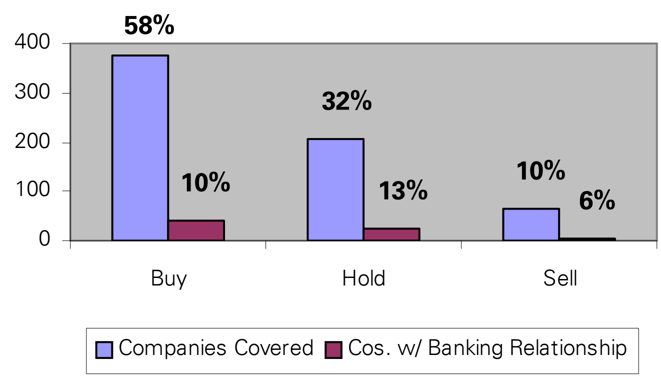

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