JANUARY 12, 2015

CARE REAFFIRMS RATINGS ASSIGNED TO THE LONG TERM DEBT INSTRUMENTS OF DHANLAXMI BANK LTD. AND REMOVES THE RATINGS FROM CREDIT WATCH

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Lower Tier II Bonds	267.70	**CARE BBB- (Triple B Minus)**	Reaffirmed
Upper Tier II Bonds	27.50	**CARE BB+ (Double B Plus)**	Reaffirmed

Rating Rationale

The ratings factor in capital infusion leading to improvement in capital adequacy in H1FY15, moderate funding and liquidity profile with high reliance on bulk deposits and low Current Account Savings Account (CASA) proportion. The ratings are constrained due to weak profitability of the bank characterized by high cost to income ratio and deteriorating asset quality. The bank's capitalization level, profitability, asset quality and resources profile are the key rating sensitivities.

The rating of Upper Tier II Bonds of Dhanlaxmi Bank Ltd. (DBL) also takes into account its sensitiveness to bank's capital adequacy ratio and profitability during the tenure of the instrument. The rating factors in additional risk arising due to existence of lock-in clause in this instrument.

The ratings were put on 'credit watch' as due to loss during FY14, the bank had reported capital adequacy ratio (CAR) of 8.67% (under Basel III) as on March 31, 2014, which was below the minimum regulatory requirement of 9% which would have triggered the lock-in clause pertaining to the Upper Tier II bonds. The ratings have been removed from 'credit watch' as the bank has raised equity capital and has serviced the interest on the Upper Tier II bonds with RBI's approval.

Background

DBL is a Kerala-based small-sized private sector bank with its headquarters at Thrissur. During 2009-2011 on account of revamping of business operations, the balance sheet size of DBL had grown substantially at a CAGR of 59%. However, FY12 onwards; against the backdrop of falling capital adequacy levels, losses and the resultant curtailment in business expansion plans resulted in decline in its asset book to Rs.13,779 crore as on March 31, 2013 from Rs.14,254 crore as on March 31, 2011. Total assets of the bank stood at Rs.13,954 crore as on September, 2014.

Mr. P.G. Jayakumar was elevated from the post of Executive Director and was appointed as the Managing Director (MD) & Chief Executive Officer (CEO) of the bank with effect from February 06, 2012. Under the new management, the bank initiated a slew of cost rationalization measures including right-sizing of the employee strength and moving to a branch-centric model (from existing vertical-based model). The bank also reduced its operational costs by surrendering of excess office space, relocation of branches/ regional offices to low cost areas and renegotiation with vendors and outsourcing agencies. The measures taken by the bank helped it report Profit After Tax (PAT) of Rs.2.62 crore on total income of Rs.1,422 crore during FY13 (refers to period from April 1, 2012 to March 31, 2013), as compared to loss of Rs.116 crore on total income of Rs.1,537 crore during FY12. However, during FY14, the advances saw negligible growth of 2% and its advances stood at Rs.7,936 crore as on March 31, 2014. Lower income due to stagnation in business growth, high operating costs, higher provisioning due to deterioration in asset quality and investment provisions severely impacted the profitability of the bank during FY14. The bank reported loss of Rs.252 crore for FY14.

During H1FY15, the profitability of the bank continued to be weak and it reported marginal profit of Rs.8 crore. As per the auditors' limited review report for H1FY15, the RBI's interim annual financial inspection has suggested additional provision of Rs.69.82 crore for divergence in NPA provisions for previous years. The bank has represented to RBI for the provision to be made in a staggered manner. The additional provisioning would put additional pressure on profitability of the bank. The bank also has large investment portfolio which would see mark to market gains in H2FY15 due to softening of interest rates.

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

The bank saw increase in its NPAs and reported Gross NPA ratio of 5.98% and Net NPA ratio of 3.80% as on March 31, 2014 as compared to Gross NPA ratio of 4.82% and Net NPA ratio of 3.36% as on March 31, 2013. Its Net NPA to Net worth ratio stood at 43.17% as on March 31, 2014 (35.96% as on March 31, 2013).

DBL reported Capital Adequacy Ratio (CAR) of 8.67% (Tier I CAR: 6.93%) (under Basel III) as on March 31, 2014 which was lower than minimum regulatory requirement of 9%. However, during H1FY15 the bank was able to raise equity capital of Rs.229.64 crore (Rs.29.64 crore during Q1FY15 and Rs.200 crore during Q2FY15) by way of preferential allotment which led to improvement in CAR to 11.65% (Tier I CAR: 10.34%) (under Basel III) as on September 30, 2014.

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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

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