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Initiating Coverage

Bandhan Bank Ltd.

12-October-2020

RETAIL RESEARCH

Bandhan Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – Pvt. Bank	Rs 325.5	Buy at LTP and add on dips to Rs 289-293 band	Rs 356	Rs 389	2 quarters

HDFC Scrip Code	BANBAN
BSE Code	541153
NSE Code	BANDHANBNK
Bloomberg	BANDHAN IN
CMP Oct 09, 2020	325.5
Equity Capital (cr)	1610.4
Face Value (Rs)	10
Eq- Share O/S(cr)	161.0
Market Cap (Rscr)	52409.0
Adj. Book Value (Rs)	94.37
Avg.52 Wk Volume	1,31,05,855
52 Week High	650.0
52 Week Low	152.2

Share holding Pattern % (Jun, 2020)	
Promoters	40.00
Institutions	40.65
Non Institutions	19.35
Total	100.0

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Our Take:

Bandhan Bank (BBL) has consistently demonstrated a strong track record in growing its balance sheet/earnings (AUM grew by CAGR 44% FY10-20) and maintained a robust market share/cost leadership with superior return ratios, pristine asset quality and low-cost DSC (door step service centers) network. The bank continues to envision being a pan-India player and intends to leverage distribution network of both entities (erstwhile Bandhan Bank and Gruh Finance that merged into it) for cross selling. Due to the nature of short duration loan, stress is identified early and remedial measures can be taken. As the lockdown is gradually lifted incidence of moratorium is falling and collection trends have been improving. Although delinquencies might increase in the short term, the bank has taken additional provisioning. With the synergies of the merger kicking in, we expect the growth momentum to resume in H2FY21.

Valuations & Recommendation:

Despite the slowdown we expect the bank to deliver RoA in the range of 3.3-3.5% and RoE of ~19-20%. BBL's is a unique franchise with ample growth visibility, stellar efficiency metrics and best-in-class return profile. We believe the premium valuations are justified given the huge opportunity in MFI business. BBL's profitability trends are superior to industry leaders given its strong margin profile, efficient cost structure and low credit costs. We have valued the bank at 2.75x FY22E ABV for a base case target of Rs 356 and 3.0x FY22E ABV for a bull case target of Rs 389 over 2 quarters. Investors can buy the stock at LTP and add on dips in the price band of Rs 289-293 (2.25xFY22E ABV).

Financial Summary

Particulars (Rs cr)	Q1FY21	Q1FY20	YoY-%	Q4FY20	QoQ-%	FY19	FY20	FY21E	FY22E
NII	1812	1575	*15.1*	1680	*7.8*	4496	6324	7533	8757
PPoP	1584	1355	*16.9*	1521	*4.2*	3748	5447	6313	7282
PAT	550	804	*-31.6*	517	*6.3*	1952	3024	2968	4217
EPS (Rs)	3.4	5.0	*-31.6*	3.2	*6.3*	16.4	18.8	18.4	26.2
P/E (x)						19.9	17.3	17.7	12.4
P/ABV (x)						3.5	3.5	3.0	2.5
RoAA (%)						3.9	4.1	3.0	3.8

(Source: Company, HDFC sec)

Recent Triggers

Q1FY21 Financials and Interim Q2FY21 numbers

Bandhan Bank reported strong earnings for Q1FY21 with PPoP growing by 16.9% yoy to Rs 1584cr. Interest income grew by 14.7% yoy while interest expenses were up by 14.2% as cost of funds contracted by 20bps to 6.4%. NIM expanded marginally by 5bps qoq. Provisions increased over five fold as the bank made additional provision of Rs 750cr related to Covid. Excluding this, provisions declined by 21% yoy. PAT declined by 32% yoy to Rs 550cr on account of higher provisioning offset partially by lower tax rates.

Advances grew 17.7% yoy and 3.5% qoq. Micro banking loans grew 21.2% yoy while non-micro banking loans grew 11.9% yoy. Consequently share of micro-banking loans rose to 63.9% yoy from 62% in Q1FY20. Moratorium declined from 71% in April to 24% in June. Micro collections improved from nil in April to 68% in June, and further to 73% in July. Savings deposits have grown 52% YoY resulting in CASA share expanding by 300bps yoy to 37.1%. The proportion of retail deposits was stable at 78%

Asset quality improved sequentially as GNPA grew by 1% and the GNPA ratio declined to 1.43% from 1.48%. NNPA witnessed a de-growth of 13.8% while the ratio contracted by 10bps to 0.48%. As per the management, collection efficiency is likely to normalize September onwards while credit cost for FY21 is likely to be 2-2.2%.

Advances book rose 3% QoQ and 20% YoY to Rs.76724 cr in Q2FY21. Total deposits rose 9% QoQ and 34% YoY to Rs.66153 cr. CASA Deposits grew 12% QoQ and 56% YoY. CASA ratio rose to 38.2% vs 32.9% in Q2FY20 and 37.1% in Q1FY21. Collection efficiency for the month of September 2020 was ~92%. Business wise break up of collection efficiency was: Micro Finance 89%, Mortgage 98%, Others (Includes SME & NBFC) 98% Overall Bank 92%. Close to 94% of Micro Finance customers paid in the month of September, 2020. Liquidity coverage ratio (LCR) as on September 30, 2020 at ~157%. During the quarter the Bank reduced minimum interest rate on saving bank deposits from 4 % p.a. to 3% p.a.

Long term Triggers

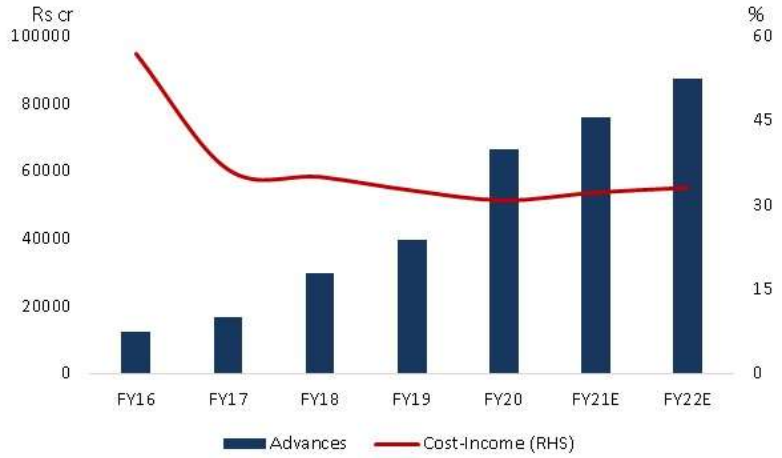
Focus on serving underbanked and underpenetrated markets

The strength of BBL lies in microfinance with a strong focus on serving underbanked and underpenetrated markets in India. While its business model has transitioned over the years, starting as a NGO in 2001, to becoming a NBFC before becoming a bank, the core focus has remained provision of micro loans. BBL reaches its customers largely through its extensive network of doorstep service centres, which

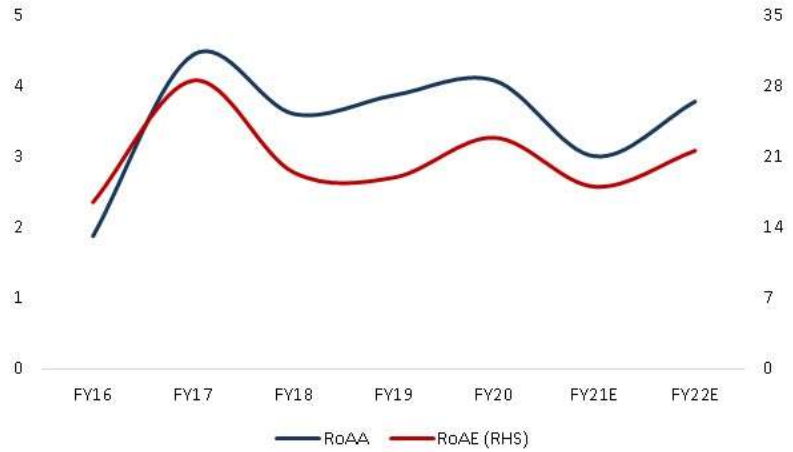
are low overhead banking outlets located nearby to customers. Given their low overheads, DSCs are a cost effective means of reaching micro loan customers, who generally are underbanked.

Bandhan Bank has 50%+ market share in East & North-east while its overall market share stood at ~20% of total MFI loans. BB's moat lies in its technology driven hub-n-spoke model with extensive presence in under penetrated areas which enables it to have one of the best operating efficiency with superior cost structure. As a result, its lending rate in the MFI business is most competitive resulting in higher customer additions and faster growth in advances. As on FY20, its total customer base stood at ~20Mn customers. State-wise it has dominant presence in West Bengal (~59% market share) followed by Assam and Bihar where its market share is 55% & 18% respectively. The microfinance market has a huge untapped potential, Bandhan Bank with its superior business model and strong market positioning is well placed to capture this opportunity.

AUM Growth has been robust; Stable Cost-Income ratio



Return ratios continue to remain strong



(Source: Company HDFC sec)

Erstwhile Bandhan Financial Services grew at a robust pace to Rs 9,500cr when it had become the largest micro finance institution in India and converted to a bank thereafter. Post the conversion to a bank, BBL has continued to grow its loan book at a strong pace with a CAGR of 46% over FY15-Q1FY21. The outstanding advances book (incl. Gruh Finance) stood at Rs 69,749cr at the end of Q1FY21. Micro loans which accounted for ~85% of the pre-merger loan book now contribute ~66% post-merger. Mortgages share 26% of the book with most of it coming from Gruh Finance.

Micro finance loans attract a higher rate of interest as these loans are largely unsecured. Being an erstwhile micro-finance institution BBL has reported high NIMs. Over the last three years BBL's calculated NIMs were in the range of 11-11.5%. However, post the merger with Gruh Finance we expect calculated NIMs to moderate by ~200-250bps to be in the range of 9-9.5%. BBL shines in funding costs, with costs at par with the best in the industry and significantly below other players which helps in higher NIMs.

Strong loan growth driven by new products

Although micro finance is going to remain the key segment for the bank, it is looking to grow its non-micro portfolio to diversify the asset book and increase granularity. Post the merger with Gruh Finance, mortgages account for ~26% of the loan book and has become a focus area for the bank. Besides mortgages the bank has diversified into SME, Retail (gold, vehicle, education, health) and NBFC loans and is looking to grow them to a commendable size. Non-micro loans had grown from ~9% of the loan book in FY17 to ~34% in FY20. Given the low base of non-micro loans aggressive management approach, these products are likely to witness strong growth in the coming years.

According to CRISIL Research, Eastern and North-eastern India, which are BBL's strongest markets, have the lowest presence of bank branches per capita of any regions in India. In terms of per capita retail credit, eastern and north eastern regions score the lowest at Rs 4000-6000 per borrower while southern and western regions have per capita retail credit at nearly 5x at Rs 19000-20000 per borrower. These regions account for ~62% of the banking outlets for BBL and have strong growth potential.

Robust capital position supported by strong profitability

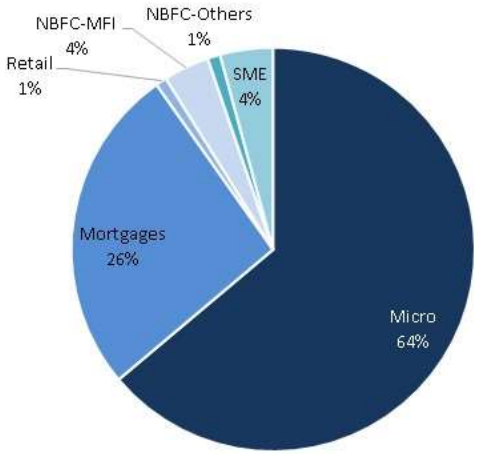
BBL has built up its networth along with scale of operations, thereby maintaining adequate capitalisation over time. As of Q1FY21 it had a CAR of 26.5% and Tier-I ratio of 23.2%. As majority of the bank's portfolio is priority sector lending (PSL), it has the opportunity and ability to generate income through PSL and inter-bank participation certificates (IBPCs), which it can monetize to earn higher fee income. BBL had raised more than Rs 6000cr over FY16-FY18 through various routes such as preferential allotment, rights issue and IPO from MF, foreign investors and domestic corporates, and with strong profitability it does not require to raise capital in the near future.

Synergy from Gruh merger to flow in the coming years

BBL announced a merger with HDFC owned Gruh Finance in Jan-2019, which was completed in Oct-19 post receiving all the necessary approvals. The share swap ratio for the amalgamation was 568 shares of Bandhan Bank for every 1,000 shares of Gruh Finance. The merger has helped the bank to diversify its loan portfolio, which was heavily skewed towards micro loans with 85% share. Gruh Finance which is mainly into affordable housing finance had a loan portfolio of Rs 18,113cr.

Post the merger, the combined entity would get synergy benefits from the fact that BBL is not into housing finance and would bring a completely new set of business perspective. There is a huge focus from the government, the prime minister, on housing finance. BBL will have access to Gruh's operating system. This will create a very large rural and semi-urban lending pool. Gruh's average loan size is Rs 8-8.4 lakh, so it typically caters to the kind of customers that BBL would cater to.

AUM break-up



(Source: Company, HDFC sec)

BBL will benefit from the fact that Gruh's operating system is time-tested, strong and survived successfully (through the) years and it will have access to western market. The branches of Gruh are mostly in Western India while BBL is focused on East and North East India. The merger would accelerate the plans of BBL to have a pan-India presence. Also, as a bank, Gruh will have access to low-cost accounts and deposits.

Apart from the traditional area of micro-finance, affordable housing will be another major growth areas for BBL going forward. Besides, micro small and medium enterprises (MSMEs) will also be a focus area. In the near future BBL has given a free hand to Gruh Finance to 'independently' decide on its growth strategies and BBL would provide necessary funding and infrastructure support to the housing finance entity for business growth.

Potential to grow other income

The strategic focus of the Bank is to become a one-stop shop experience for all banking services to its customers. In FY19 the bank started distribution of general and life insurance products from its branches. Mutual funds are being distributed only through select metro and urban branches and as of FY20 534 branches are 'live for Mutual Fund distribution (460 in FY19), and general insurance and life insurance products are sold through through 699 branches. Core fee income grew by 133% in FY20 to Rs 800cr and contributed 52% to the total other income. Higher distribution of third-party products is likely to result in faster growth in fee income. For life insurance, the bank has partnered with HDFC Life, Bajaj Allianz and Kotak Mahindra Life. In case of non-life insurance, it is in partnership with New India Assurance and Bajaj Allianz for general insurance and HDFC Ergo for health insurance. Apart from this, it has also launched co-branded credit card with Standard Chartered Bank.

BBL is also looking to leverage its strong PSL (Priority Sector Lending)-compliant portfolio by increasingly selling PSL certificates to non-PSL compliant banks. RBI has mandated 40% PSL lending for all banks. Since a major portion of BBL's loan book qualifies as PSL it earns significant revenues from selling PSL certificates to other non-compliant banks. Revenues earned from sale of PSL certificates increased from Rs 309cr in FY19 to Rs 453cr in FY20 and accounted for 29% of other income.

Increasing CASA share to bring down cost of funds

BBL has been able to build a strong deposit franchise within a short period of time. Total deposits have grown at a phenomenal pace to Rs 66,153cr at the end of Q2FY21 while CASA deposits stood at Rs 25,279cr giving a CASA ratio of 38.2%. CASA ratio has increased to 40.75%

at the end of FY19, but due to the restrictions imposed by RBI on opening of new branches and inclusion of deposits of Gruh, CASA ratio declined. The RBI has now lifted the restriction on opening of new branches and CASA ratio is likely to move higher from current levels.

Access to low cost CASA funds gives BBL a stable source of low-cost funding, allowing it to provide cost-effective loans to the target customer base. One of the reasons for strong growth in CASA deposits was the higher interest rates offered by the bank on savings deposit of upto 6% on deposits over Rs 1 lakh and zero penalties on non-maintenance of monthly average balance. The bank has passed on the lower cost of funds to its micro loans customer by reducing the interest rate from over 22% in 2015 to below 17% currently.

Growing share of CASA deposits

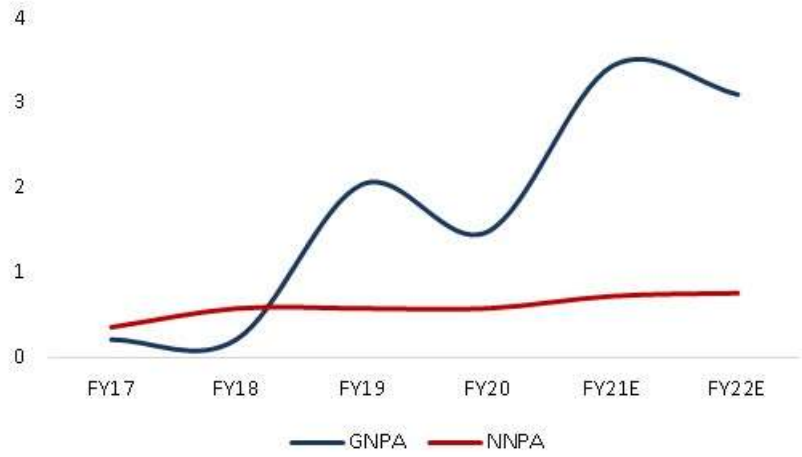
(Source: Company, HDFC sec)

Asset quality well placed

Bandhan Bank reported an improvement in asset quality ratios in Q1FY21 with gross NPAs down ~5bps qoq to 1.43% and net NPAs down ~10bps to 0.48%. Provision coverage ratio improved to 67% (up ~600 bps qoq). Almost 24% of the loan book was under moratorium as of

June 2020 and the company has made provisions in excess of RBI requirements. As of Q1FY21, including Covid-related contingent provisions of Rs 1440cr, the bank has additional provisions of ~Rs 1769cr. Management has indicated that collection efficiency in the MFI business has recovered to 92% in Sep-20, and is improving day by day.

Covid stress could result in asset quality deterioration in FY21



(Source: Company, HDFC sec)

RBI restriction on branch opening lifted

In Sep-18, RBI restricted BBL from opening new branches and ordered a freeze on the remuneration of its managing director and chief executive officer Chandra Shekhar Ghosh for not meeting the bank promoter shareholding norms. RBI's licencing guidelines required BFHL, the banks' promoter company, to reduce its stake from 82% to 40% within three years of commencing business. The deadline for BBL was August 23, 2018 which it failed to meet.

It relaxed the restriction in Feb-20, considering the efforts made by the bank to comply with the licensing conditions. Due to the merger with Gruh Finance, promoter holding has declined from 82.26% in Sep-19 to 60.96% in Dec-19. The central bank has lifted the restriction subject to condition that the bank ensures at least 25% of the total number of 'Banking Outlets' opened during a financial year are opened in unbanked rural centres. Meeting this criterion of the central bank should not be difficult for BBL as it is primarily a micro-finance institution catering to clients in semi-urban and rural areas.

In Aug-2020 the promoter Bandhan Financial Holdings (BFHL) diluted 20.95% of its stake to bring it down to 40% in compliance with RBI guidelines. The stake was sold to four investors i.e. BlackRock, GIC, Temasek and SBI Mutual Fund. BFHL may use the proceeds to start an insurance and mutual funds unit and BBL is likely to benefit from higher fee income on distribution. BFHL is required to reduce its shareholding further to 20% and 15% within 10 years (August 2025) and 12 years (August 2027), respectively, from the date of commencement of business as a Bank.

What could go wrong

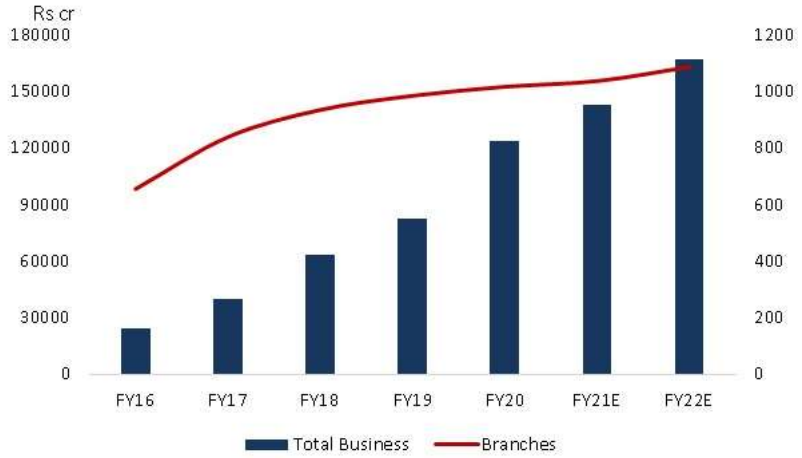
- Competition from large private sector banks in building up its deposit franchise and improving CASA ratio. Private banks are also focusing on scaling up their deposit base Also Banks and new MFIs are expanding their activities in Microfinance bringing competition for BBL.
- Political instigation in some of the states asking people not to pay back their dues could result in higher NPAs. BBL has huge dependence and concentration in East and North east region for its MFI business. Any unexpected event of natural catastrophe in these regions can impact its growth and asset quality.
- Integration with Gruh could pose a challenge if some the key people responsible for its superior performance leave the organization post the merger.
- Mr. C S Ghosh is the MD & CEO of the bank and has over 39 years of experience in the finance and microfinance sector. BBL has a key man risk in as much as without Mr. C S Ghosh at the helm, execution risk for Bandhan will be higher and may hamper implementation of growth plans.
- BBL's business could be directly affected by any changes in policies for banks with respect to directed lending, reserve requirements, provisioning and other areas. Also if there is a margin cap on the MFI lending, BBL's profits could get impacted.
- Microloans are not generally backed by collateral, they may pose a higher degree of risk than loans secured with physical collateral.

About the company

Set up as Bandhan Financial Services Pvt. Ltd (BFSL) in 2006, BFSL was the largest NBFC-MFI in India until 2014 after which, it became the first entity to receive an in-principle universal banking licence from the Reserve Bank of India. After it commenced operations in August 2015, BFSL's entire microfinance portfolio was transferred to Bandhan's book. The bank is headquartered in Kolkata and offers group-based individual lending services for the microfinance business. It operates through a network of 4,315 branches, doorstep service centres (DSCs), and GRUH centres, spread across 34 states and Union Territories.

In 2019, the bank acquired Gruh with the dual objective of reducing the promoter shareholding to the stipulated level and to diversify operations both geographically and across asset classes. Gruh has 195 centres in 11 states and 1 Union Territory, most of which are in the western part of India.

Business growth



(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	4802	6644	10885	13420	15181
Interest Expenses	1770	2148	4562	5887	6424
Net Interest Income	**3032**	**4496**	**6324**	**7533**	**8757**
Non interest income	706	1063	1549	1782	2123
Operating Income	**3738**	**5559**	**7873**	**9315**	**10880**
Operating Expenses	1308	1811	2427	3002	3598
PPoP	2430	3748	5447	6313	7282
Prov & Cont	374	735	1393	2345	1645
Profit Before Tax	2056	3013	4053	3968	5638
Tax	710	1062	1030	1000	1421
PAT	**1346**	**1952**	**3024**	**2968**	**4217**

BALANCE SHEET

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Share Capital	1193	1193	1610	1610	1610
Reserves & Surplus	8189	10009	13585	16070	19723
Shareholder funds	**9382**	**11202**	**15195**	**17680**	**21333**
Deposits	33869	43232	57082	66779	79870
Borrowings	285	521	16379	13672	8735
Other Liab & Prov.	774	1487	3062	7340	7449
SOURCES OF FUNDS	**44310**	**56442**	**91719**	**105471**	**117387**
Cash & Bank Balance	5511	5803	8353	8281	7428
Investment	8372	10037	15352	19749	20964
Advances	29713	39643	66630	75958	87352
Fixed Assets	238	331	369	367	415
Other Assets	476	627	1014	1116	1227
TOTAL ASSETS	**44310**	**56442**	**91718**	**105471**	**117387**

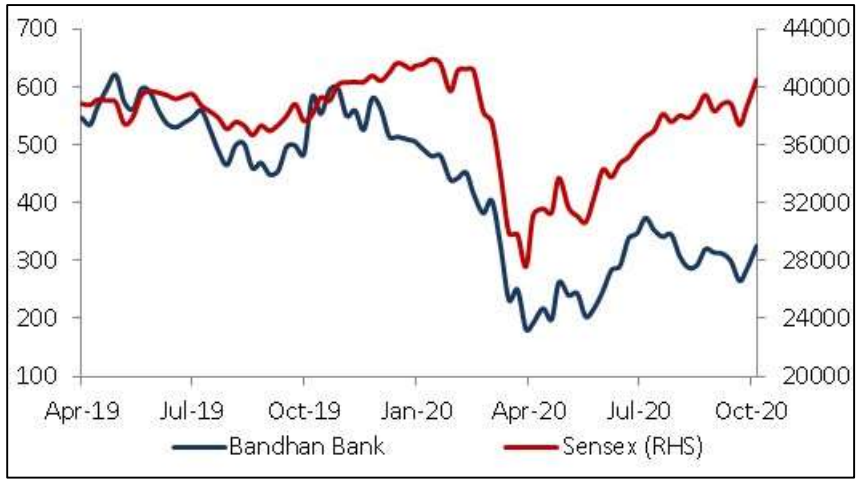
Balance Sheet

As at March (Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Return Ratios (%)					
Calc. Yield on adv	20.6	19.2	20.5	18.8	18.6
Calc. Cost of borr	6.1	5.5	7.8	7.7	7.6
Calc. NIM	11.4	11.5	11.1	9.5	9.0
RoAE	19.5	19.0	22.9	18.1	21.6
RoAA	3.6	3.9	4.1	3.0	3.8
Asset Quality Ratios (%)					
GNPA	0.22	2.04	1.48	3.43	2.90
NNPA	0.58	0.58	0.58	0.55	0.54
PCR	53.7	72.1	60.8	84.0	81.5
Growth Ratios (%)					
Advances	76.5	33.4	68.1	14.0	15.0
Borrowings	45.8	27.6	32.0	17.0	19.6
NII	26.2	48.3	40.7	19.1	16.3
PPP	35.5	54.2	45.3	15.9	15.4
PAT	21.0	45.0	54.9	-1.9	42.1
Valuation Ratios					
EPS (Rs)	11.3	16.4	18.8	18.4	26.2
P/E (x)	28.9	19.9	17.3	17.7	12.4
Adj. BVPS (Rs)	77.2	92.0	91.9	107.2	129.6
P/ABV (x)	4.1	3.5	3.4	3.0	2.5
Dividend per share (Rs)	1.0	3.0	0.0	3.0	3.5
Dividend Yield (%)	0.3	0.9	0.0	0.9	1.1
Other Ratios					
Cost-Income (%)	35.0	32.6	30.8	32.2	33.1
Leverage (x)	3.2	3.5	4.4	4.3	4.1

Bandhan Bank Ltd.

(Source: Company, HDFC sec Research)

Price Chart



Disclosure:

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Mutual Funds Investments are subject to market risk. Please read the offer and scheme related documents carefully before investing.