Bandhan Bank Limited

January 06, 2020

Rating

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Unsecured Subordinated Non-convertible Debenture	**160 (Rupees One Hundred and Sixty Crore only)**	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Removed from credit watch; Rating Reaffirmed

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

CARE had placed the ratings assigned to Bandhan Bank Ltd (BBL) on credit watch with developing implications following the approval of scheme of amalgamation of GRUH Finance Limited (GFL) with BBL by the bank's Board of Directors in January 2019.

The rating has been reaffirmed and removed from credit watch on completion of the amalgamation and assessment of the impact of the amalgamation on the credit risk profile of BBL.

The rating takes note of the increase in diversification of the product wise loan portfolio of BBL with amalgamation of GFL, improvement in geographical diversification and continued comfortable asset quality post amalgamation.

The rating continues to derive comfort from the experienced promoter group and patronage of strong domestic and foreign investors, mobilization of substantial deposits base with high proportion of retail deposits, robust capitalization, healthy profitability and comfortable liquidity profile.

The rating, however, continues to remain constrained by the concentration of lending portfolio towards micro advances, which remained high at about 61% of advances as on September 30, 2019 post amalgamation of GFL, though reduced from 86% as on Mar.31, 2019. Further, the bank continues to have geographical concentration in eastern and north eastern India at about 60% of its branch presence. The micro finance portfolio is largely concentrated in West Bengal exposing BBL to event based risk. Further, the rating takes note of housing finance being a relatively new area of business for BBL and foray into newer area of general banking business which is characterized by intense competition.

The stake of the non-operative financial holding company (NOFHC) has reduced to 60.96% from 82.26% after the amalgamation of GFL. However, it continues to remain higher than the stipulated 40%. Complying with RBI stipulation to reduce promoter's stake as per the licensing norms and any development in this regard is a key rating monitorable.

Rating Sensitivities

Positive factors

- Reduction in concentration of micro finance loan book below 30% on a sustained basis
- Net NPA remaining below 0.5% on a sustained basis
- Further improvement in geographical diversification

Negative Factors

- Significant weakening of asset quality
- Deterioration in capitalisation with the Tier I capital ratio below 15%
- Any regulatory action on inability to reduce promoter holding impacting operations.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoter group along with patronage of strong domestic and foreign investors

BBL was promoted by Bandhan Financial Services Ltd (BFSL; the business of which has been transferred to BBL) which occupied leadership position in the MFI sector and is its step down subsidiary. BFSL holds 60.96% stake in BBL through NOFHC named Bandhan Financial Holdings Ltd (BFHL).

BFSL was promoted by Mr. Chandra Shekhar Ghosh (MD & CEO of BBL) who has an aggregate experience of over two decades in micro-financing activity which remains the core area of business of the bank. Moreover, the shareholders of BBL comprises of reputed investors like HDFC Limited (post-merger of GFL), SIDBI, International Finance Corporation (IFC - the private equity arm of World Bank) and GIC (a sovereign wealth fund of Singapore).

Increasing operational presence

BBL commenced its operations on Aug.23, 2015 with a branch network of around 501 branches across India. The branch presence of BBL increased from 936 as on March 31, 2018 to 986 as on March 31, 2019 and further to 1000 branches as on September 30, 2019 across India. The operations of BBL are also supported by around 3025 Door step services (DSCs), which

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

facilitate the microfinance operations of BBL. Including the 195 branches of GFL post amalgamation, BBL had 4220 banking outlets as on Sep.30, 2019.

Further, 106 branches of BBL have been enabled with GFL loan sales to explore cross selling of GFL loans to existing BBL customers. Presently the bank has presence in 34 states and union territories in India.

Increasing deposit base

The deposit base of the bank grew from Rs.33,869 crore as on Mar.31, 2018 to Rs.43,232 crore as on Mar.31, 2019 and further to Rs.49,195 crore as on Sep.30, 2019. The proportion of lower cost current accounts and savings account (CASA) deposit increased from 21.56% as on March 31, 2016 (first year of banking operations) to 40.75% as on March 2019 as BBL continued to focus on its banking activities. However, the proportion of CASA deposit declined to 32.91% as on September 30, 2019 with higher mobilisation from term deposits and inclusion of term deposit of Rs.1,608 crore of GFL.

Increase in proportion of CASA deposit mobilization enabled BBL to reduce the average cost of funds from 6.06% in FY18 to 5.51% in FY19. Further, the micro loan customers only accounted for about 7% of deposits as on Mar.31, 2019 indicating ability of the bank to garner deposits from a newer customer base.

The retail deposits constituted about 78% of deposits as on September 30, 2019.

Robust capitalization

Overall CAR and Tier I CAR of the bank remained healthy at 29.20% and 27.88% as on Mar.31, 2019. As on September 30, 2019, the merged overall CAR and Tier I CAR moderated to 25.09% and 23.01% respectively despite increase in tangible networth mainly due to higher leverage in GFL. The overall gearing also increased to 4.69x as on Sep.30, 2019 from 3.91x as on Mar.31, 2019.

However, the CAR continues to remain significantly higher than the regulatory requirement.

Comfortable asset quality with adequately seasoned portfolio

The asset quality of BBL deteriorated with GNPA increasing from 1.25% as on Mar.31, 2018 to 2.04% as on March 31, 2019 mainly due to the effect of one large corporate exposure of about Rs.388 crore which has been fully provided for. Without the effect of the same, the GNPA would have been 1.09% as on March 31, 2019. Further, BBL does not have any restructured accounts.

As on September 30, 2019, around 54% of the micro loan was for borrowers with 4th cycle and above, which is an indication of seasoned portfolio with matured borrowers. The average ticket size of BBL's borrowers was Rs.63,400 as on September 30, 2019.

Post amalgamation of GFL, the asset quality remained comfortable with GNPA of 1.76% and net NPA of 0.56%.

Healthy profitability

Total income of BBL increased by about 40% in FY19 over FY18 driven by significant growth in interest income and other income mainly comprising commission and brokerage income and income from sale of priority sector lending certificates. NIM improved to 8.53% from 7.28% in FY18 with increase in yield on advances and lower cost of borrowings. Average cost of borrowing was lower with increase in CASA deposits in deposits mix.

The opex/average total assets increased marginally from 3.28% in FY18 to 3.44% in FY19 with opening of new branches. The credit cost deteriorated from 1% in FY18 to 1.46% in FY19, mainly due to high one-time provision for a corporate exposure. ROTA increased from 3.61% in FY18 to 3.87% in FY19.

The profitability remained healthy post amalgamation of GFL with BBL. The bank reported PAT of Rs.1775 crore in H1FY20 post-merger of GFL as against standalone PAT of Rs.1951.5 crore in FY19.

Key Rating Weaknesses

Concentration of micro advances in portfolio, though the same reduced post amalgamation of GFL

BBL's portfolio predominantly consisted of micro loans with 86% of the loan outstanding as micro loan as on March 31, 2018 as well as March 31, 2019.

The proportion of micro loans reduced to 61% as on September 30, 2019, post the inclusion of housing loan portfolio of GFL. However, the same continues to remain high exposing BBL to event based risk associated with micro loans and unsecured nature of lending. GFL's portfolio constituted 28% of BBL's Assets under Management (AUM) as on September 30, 2019. Further reduction in micro loan portfolio with higher penetration of general banking business of BBL and successful expansion of housing finance portfolio which is a relatively new area of business for the bank is a key rating sensitivity.

High geographical concentration

The inheritance of the micro advance portfolio by BBL from BFSL is primarily concentrated in West Bengal, which has resulted in inherently higher concentration of portfolio in the state.

However, the proportion of branches and DSCs in WB has reduced over the past few years and is expected to reduce further in the medium term after amalgamation of GFL, which had operations largely in western and central India.
As a result of amalgamation of GFL, the concentration of branches in the east has reduced from 53% as on March 31, 2018 to 49% as on September 30, 2019, whereas the concentration of branches in Central India has increased from 13% as on March 31, 2018 to 17% as on September 30, 2019. However, the concentration to eastern India continues to remain high.

Intense competitive pressure
Despite inheritance of established micro finance business of BFSL which occupied the leadership position in the MFI sector, the operations of BBL is expected to face intense competition in the light of RBI granting new banking licenses comprising of payment banks and small finance banks for deepening financial inclusion objectives of the regulator. Further, in the retail lending sector, BBL has to establish its track record and appeal to newer urban customers amidst intense competition from established public sector and private sector banks which already has a major share of the market.
Going forward, BBL's ability to gain from merger of GFL also remains to be seen.

Regulatory risk
The bank was required to reduce the promoters holding (NOFHC) to 40% within three year of operation i.e by August, 2018 as per the RBI's new banking licensing guidelines. Due to non-compliance with the regulatory requirement, RBI had earlier imposed restrictions on opening of branches by the bank and a penalty was also imposed recently. The amalgamation of GFL with BBL has led to reduction in promoter holding to 60.96%. However, it is still above 40%. Developments with respect to the stake dilution remain to be observed and critical.

Liquidity: Strong
The structural liquidity statement of BBL (standalone) indicates positive cumulative mismatches across all time buckets.
The liquidity profile of the bank is strong and is supported by the high capitalization levels apart from maintaining the regulatory CRR and SLR levels. Further, the lower tenure of advances financed (majority of micro loan has a tenure of 12-24 months which form about 61% of advances) vis-à-vis the longer tenure of funding profile also provides liquidity comfort. Access to inter-bank participation certificate (IBPC) market also supports the liquidity profile as a major part of the portfolio (around 92% of gross advances as on Sep.30, 2019), qualifies for priority sector lending. Excess SLR as on September 30, 2019 was Rs.6298.26 crore. Liquidity coverage ratio was high at 179.92% as on Sep.30, 2019.

Analytical Approach: Standalone

Applicable Criteria:
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios –Financial Sector
Bank – CARE's Rating Methodology for Banks

About the Company
BBL was incorporated on Dec.23, 2014, promoted by BFSL as its step down subsidiary. BFSL was a NBFC-MFI which was engaged in the business of lending to individual women borrowers under 'Group based individual lending' model and operated across 22 states & Union Territories of India. BFSL was granted approval by RBI on April 2, 2014 to set up a bank under 'Guidelines on Licensing of New Banks in the Private Sector'. Subsequently, on June 17, 2015, RBI granted the license to BBL to carry out the banking business in India. BBL formally commenced its banking operations on Aug.23, 2015 with 501 branches on a pan India basis. In line with the terms of Business Transfer Agreement (BTA) dated Feb.11, 2015 entered between BFSL and BBL, the entire assets/liabilities of BFSL were transferred to BBL.
BBL was listed in March 2018 through an IPO and Rs.3662 crore was infused in the bank.
The Board of BBL comprises of 12 members and is headed by Dr. A.K. Sinha (Non-Executive Independent Chairman). The operations are looked after by Mr. Chandra Shekhar Ghosh (MD & CEO - founder of BFSL).
In January 2019, the Board of BBL had announced the approval of scheme of amalgamation of GFL with BBL. The merger was completed in October 2019 after receipt of all required regulatory approvals with effective date of Oct.17, 2019 and appointed date of Jan.1, 2019.
GFL was a Housing Finance Company with gross loan portfolio of Rs.17,288 crore as on Mar 31, 2019 concentrated mainly in West and Central India with HDFC Limited being the single largest shareholder (57.86%). GFL operated primarily in the rural and semi urban areas of Gujarat and Maharashtra.
As on September 30, 2019, the combined AUM of GFL and BBL was Rs.64,186 crore (Rs.44,776.08 crore as on Mar.31, 2019 BBL standalone) spread across 34 states & UTs through 4220 branches (includes branches, DSCs & GFL centres).

Brief Financials (Rs. Crore)	FY18 (A)	FY19 (A)
Total income	5,508.48	7,707.10
PAT	1,345.56	1,951.50
Interest coverage (times)	2.42	2.78
Total Assets	44,310.07	56,441.70
Net NPA (%)	0.58	0.58
ROTA (%)	3.61	3.87

A: Audited

CARE has made analytical adjustments while calculating the ratios.

Status of non-cooperation with previous CRA:

Not Applicable

Any other information:

Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debt-Subordinate Debt	INE545U08019	September 02, 2014	14.536	September 02, 2021	160.00	CARE AA-; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	-	-	-	-	1)Withdrawn (06-Oct-17)	1)CARE AA- (10-Nov-16)
2.	Debt-Subordinate Debt	LT	160.00	CARE AA-; Stable	-	1)CARE AA- (Under Credit watch with Developing Implications) (08-Jan-19) 2)CARE AA-; Stable (10-Oct-18)	1)CARE AA-; Stable (06-Oct-17)	1)CARE AA- (10-Nov-16)
3.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (10-Nov-16)

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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