Bandhan Bank Limited (Revised)

January 8, 2019

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Unsecured Subordinated Non-convertible Debenture	**160 (Rupees One Hundred and Sixty Crore only)**	**CARE AA-; Credit watch with developing implications (Double A Minus, under credit watch with developing implications)**	**Placed on credit watch with developing implications**

Details of instruments/facilities in Annexure-1

Detailed Rationale and Key Rating Drivers

CARE has placed the rating assigned to Bandhan Bank Ltd (BBL) on credit watch with developing implications. The rating action follows the approval of scheme of amalgamation of GRUH Finance Limited (GFL) with BBL by the bank's Board of Directors. The scheme is subject to receipt of various statutory and regulatory approvals. The Appointed date for the scheme shall be January 1, 2019 or such other date as is mutually agreed between the amalgamating companies.

Further, the Board also approved the execution of Merger Cooperation Agreement which sets out the manner of effecting the proposed amalgamation contemplated under the scheme, the representation and warranties given by each party and the rights and obligations of the respective parties. As per the scheme of amalgamation, every shareholder of GFL shall receive 568 shares of BBL for 1000 shares held in GFL.

The proposed amalgamation is a positive step by BBL towards complying with RBI stipulation to reduce promoter's stake as per the licensing norms. The stake of the Non Operative Financial Holding Company of BBL is expected to reduce to ~61% on completion of the transaction and HDFC Ltd will have a stake of about 15% in BBL.

GFL is a Housing Finance Company (HFC) with gross loan portfolio of Rs.16,663 crore as on September 30, 2018. HDFC Limited is the single largest shareholder with 57.86% stake in GFL. GFL operates primarily in the rural and semi urban areas of Gujarat and Maharashtra. The company had a distribution network of 195 retail offices across 11 states and 1 union territory as on September 30, 2018. The proposed amalgamation is expected to lead to reduction in concentration of advances to micro finance loans as well as mitigate the geographical concentration risk to an extent.

CARE will continue to monitor the developments in this regard and will take a view on the rating once the merger process is completed and the exact implication of the merger on the credit profile of BBL is clear.

The rating assigned to BBL continues to derive comfort from the experienced promoter group and patronage of strong domestic and foreign investors, mobilization of substantial deposits base within a short period of commencement of banking operation leading to reduction in borrowing cost, increasing scale of banking operation, growing micro loan portfolio, robust capitalization post Initial Public Offering (IPO) and healthy liquidity profile, legacy of established credit operations and strong operational network in the non-urban areas through the activities of Bandhan Financial Services Ltd. (BFSL; the business of which has been transferred to BBL) which occupied leadership position in the MFI sector, inheritance of large client base of BFSL and efficient risk management practices leading to comfortable asset quality parameters of BBL. The rating also factors in the healthy profitability.

The rating is, however, constrained by BBL's foray into newer area of general banking business which is characterized by intense competition, concentration of lending portfolio towards micro advances which is largely concentrated in West Bengal exposing BBL to event based risk and moderate concentration in deposit base. Further, the rating also takes into account the inherent regulatory risk and recent development with respect to restriction on opening of new branches without prior approval of RBI and complying with RBI stipulation to reduce promoter's stake as per the licensing norms. Any development in this regard is a key rating monitorable.

Detailed description of Key Rating Drivers

Key Rating Strengths

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

BBL has been promoted by BFSL and is its step down subsidiary. BFSL was promoted by Mr. Chandra Shekhar Ghosh (MD &CEO of BBL) who has an aggregate experience of over two decades in microfinancing activity. Moreover, the shareholders of BBL also comprises of reputed investors like SIDBI, International Finance Corporation (IFC - the private equity arm of World Bank) and GIC (a sovereign wealth fund of Singapore).

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

Increasing operational presence

BBL commenced its operations on Aug.23, 2015 with a branch network of around 501 branches across India. The number of branches of BBL increased to 938 as on September 30, 2018. Further, the operational structure comprised of 3010 micro banking centres and 476 ATMs on a pan India basis as on Sept.30, 2018.

However, opening of new branches has been restricted by RBI due to its inability to reduce the promoters holding (Non Operative Financial Holding Company- NOFHC) below 40% within three year of operation i.e August 23, 2018 as per the RBI's new banking licensing guidelines. RBI also froze the remuneration of Mr. Chandra Shekhar Ghosh at existing levels. BBL can open new branches with prior approval of RBI and has already received approval for opening 40 new branches.
With significant growth potential from the existing branch network, the growth prospects in the short term are not likely to be impacted. However, if the restriction of opening branch with prior permission continues, it may have impact on the growth parameters in the medium to long term.

Mobilization of substantial deposit base with, leading to decline in interest rate charged

Post conversion into a bank, BBL has gained access to low cost funding sources. During FY18, BBL had mobilized substantial amount of deposits which stood at Rs.33,869 crore as on Mar.31, 2018 (increased from Rs.23,229 crore as on Mar.31, 2017). Further, the CASA deposits stood at Rs.11,624 crore as on Mar.31, 2018. As on September 30, 2018, the deposits mobilized by BBL stood at around Rs.32,959 crore. Mobilisation of such deposits enabled BBL to reduce its cost of borrowing and also pass on the benefits to its customers thereby increasing its competitiveness. Apart from such deposits, BBL's other funding sources includes inter bank borrowings, capital market instruments, Inter Bank Participation Certificates (IBPC) and certificate of deposits.

Robust capitalization post IPO

Overall Capital Adequacy Ratio (CAR) of the bank stood improved to 31.48% as on March 31, 2018 as against 26.36% as on March 31, 2017 vis-à-vis the regulatory requirement of 13%. As on September 30, 2018, the CAR further improved and stood at 32.6%. Such healthy capitalization reflects the support from the existing institutional investors of the company and provides sufficient headroom for the company to pursue growth in a highly competitive industry. Moreover, the liquidity profile of the bank 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 months) vis-à-vis the longer tenure of funding profile also provides liquidity comfort. Access to securitisation market is also likely to support the liquidity profile of the company as a major part of the portfolio qualifies for priority sector lending.

Inheritance of large client base of BFSL which occupied the dominant position in the MFI sector

The underlying business of BBL has been transferred from BFSL as per the BTA entered into by both the entities. BFSL which had been operational for over a decade, occupied a dominant position in the microfinance sector in terms of outstanding loan portfolio (including off-book), which has witnessed continuous growth and reached Rs.9,524.45 crore as on Mar.31, 2015. The same, after its transfer to BBL has witnessed continuous growth and reached Rs.32,339 crore(gross advances) as on March 31, 2018 (Rs.23,543 as on March 31, 2017). Despite such considerable size of advances, BBL's stringent risk management practice ensured negligible slippages wherein the collection efficiency stood well above 98% in FY18. Inheritance of such considerable seasoned portfolio along with the necessary risk management infrastructure of BFSL to maintain negligible slippages provides BBL with strong business fundamentals.

Continued growth in micro advances with gradual diversification into general banking

BBL had total gross outstanding portfolio (including managed portfolio) of Rs.32,339 crore as on Mar.31, 2018 as against Rs.23,543 crore as on Mar.31, 2017. Out of such outstanding portfolio, the gross micro loan portfolio of BBL increased and stood at Rs.27,610 crore as against at Rs.21,386.55 crore as on Mar.31, 2017 and comprised of 85% of the total outstanding gross advance portfolio as on Mar.31, 2018. As on September 30, the total outstanding portfolio increased to Rs.33,373 crore.
Moreover, BBL is gradually diversifying its advance portfolio by developing its general banking business by offering new products. Advances under such general banking stood at Rs.4,729 crore as on March 31, 2018 as against Rs.2,156.73 crore as on Mar.31, 2017. However, lack of expertise in such newer credit areas might impact the growth momentum of the general banking vertical of BBL.

Comfortable financial risk profile with improvement in profitability in FY18

The profitability of BBL improved in FY18 vis-à-vis FY17. However, the ROTA and RONW declined to 3.61% and 19.46% in FY18 as against ROTA of 4.45% and RONW of 28.58%. The decline in ROTA in FY18 was on account of significant increase in asset base in the last quarter of FY18, the benefits from the same could not be earned for the entire year and decline in RONW was on account receipt of public issue from listing of the bank on March 27, 2018 which increased the networth of the bank as on March 31, 2018 significantly without deriving the benefits of the same which resulted in reduction in average return.
With access to low cost of funding and diversification in low yield products, BBL's lending rates reduced which led to reduction in NIM to 7.40% in FY18 as against 8.72% in FY17. Overall gearing improved to 3.64x as on March 31, 2018 as against 5.46x in FY17 on account of significant receipt of funds from public issue.

Comfortable asset quality

The asset quality of BBL as on Mar.31, 2018 remain comfortable. The stringent credit appraisal and loan monitoring process as imbibed from the operational discipline of BFSL has enabled BBL to report low delinquencies. Further, the bank did not have any restructured accounts during FY18. The Gross NPA of BBL as on Mar.31, 2018 stood at 1.25% vis-à-vis 0.51% as on Mar.31, 2017. As on September 30, 2018, the Gross NPA Ratio and the Net NPA Ratio stood at 1.29% and 0.69% respectively. However, the performance of asset quality in newer segment wherein the bank has low experience remains to be seen. As on September 30, 2018, the bank had an exposure of Rs.388.48 crore to a single entity in infrastructure development and finance sector with weak credit profile. Adjusting for the same, the GNPA% would increase to 2.53%.

Key Rating Weaknesses

High geographical concentration with West Bengal contributing majority of business

The inheritance of the micro advance portfolio by BBL from BFSL is primarily concentrated in West Bengal. Out of AUM of BBL amounting to Rs.32,339 as on Mar.31, 2018, advances amounting to Rs.14,054.26 crore pertained to West Bengal alone. Accordingly 43.46% of gross advances of BBL as on Mar.31, 2018 originated from West Bengal (45% as on March 31, 2017), thereby reflecting geographical concentration of advances exposing the company to event based risk. Further, 355 branches are in West Bengal alone. The deposit base of BBL was moderately concentrated as on Mar.31, 2018 with top 20 depositors contributing to about 18.75% of deposits.

Intense competitive pressure

Despite inheritance of established micro finance business of BFSL which occupied a dominant leadership position in the MFI sector, the operations of BBL are expected to face intense competition in the light of RBI granting new banking licenses 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 have a major share of the market.

However, gradual reduction of interest rates by BBL on the back of its low cost of funding and gradual increase of market presence in urban and semi urban areas is expected to enable BBL to tackle such competitive pressure.

Product Concentration Risk

Out of the total advances, 85.38% was towards micro loans as on March 31, 2018, reflecting product concentration.

Regulatory Risk

The bank is exposed to risk associated with the restrictions imposed by RBI which can affect the growth profile of the bank. RBI has restricted BBL from opening new branches freely due to its inability to reduce the promoters holding (Non Operative Financial Holding Company- NOFHC) below 40% within three year of operation i.e August 23, 2018 as per the RBI's new banking licensing guidelines. Subsequently, RBI granted permission to open 40 branches. The proposed amalgamation of GFL with BBL will lead to reduction in the stake of the NOFHC. However, further stake dilution will be required and developments with respect to the same remains to be observed and critical.

Liquidity

The liquidity profile of the bank is healthy and 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 months) vis-à-vis the longer tenure of funding profile also provides liquidity comfort. Access to securitisation market is also likely to support the liquidity profile of the company as a major part of the portfolio qualifies for priority sector lending.

Analytical Approach: Standalone

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Financial Ratios- Financial sector
CARE's Rating Methodology for Banks
Criteria for placing rating on credit watch

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 & UTs of India. BFSL was granted "in-principle" approval by RBI on April 2, 2014 to set up a bank under 'Guidelines on Licensing of New Banks in the Private Sector' issued by RBI. 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.

Brief Financials (Rs. crore)	FY17 (A)	FY18(A)
Total income	4,320.1	5,508.5
PAT	1112.0	1345.6
Interest coverage (times)	2.24	2.42
Total Assets	30236.1	44310.1
Net NPA (%)	0.36	0.58
ROTA (%)	4.45	3.61

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

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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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debt-Subordinate Debt	September 02, 2014	14.536	September 02, 2021	160.00	CARE AA- (Under Credit watch with Developing Implications)

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (06-Oct-17)	1)CARE AA- (10-Nov-16)	1)CARE A+ (16-Nov-15)
2.	Debt-Subordinate Debt	LT	160.00	CARE AA- (Under Credit watch with Developing Implications)	1)CARE AA-; Stable (10-Oct-18)	1)CARE AA-; Stable (06-Oct-17)	1)CARE AA- (10-Nov-16)	1)CARE A (16-Nov-15)
3.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (10-Nov-16)	1)CARE A+ (16-Nov-15)

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