February 24, 2021

Bandhan Bank Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated Tier II NCD	160.00	160.00	[ICRA]AA (Stable); reaffirmed
NCD Programme	196.40	196.40	[ICRA]AA (Stable); reaffirmed
Term Loans from Banks	80.00	80.00	[ICRA]AA (Stable); reaffirmed
Certificates of Deposit	3,000.00	3,000.00	[ICRA]A1+; reaffirmed
NCD Programme	30.00	0.00	[ICRA]AA (Stable); reaffirmed and withdrawn
Total	**3,466.40**	**3,436.40**	

**Instrument details are provided in Annexure-1; NCD – Non-convertible debentures*

Rationale

The ratings reaffirmation takes into account Bandhan Bank Limited's (BBL) strong operating profitability and capital position, which are likely to provide a cushion against the expected losses that will arise on account of the expected stress on the asset quality following the Covid-19 pandemic. In 9M FY2021, the bank reported a sharp jump in fresh slippages, which stood at ~Rs. 4,691 crore (~9% of standard advances and ~10% of micro loans as on March 31, 2020) on a proforma basis. In addition, the uncertainty regarding the asset quality has increased because of the announcement of microfinance loan waivers in Assam, which accounts for ~14% of the bank's micro loans. The announcement has led to a further decline in the collection efficiency by 10% to 78% in January 2021, though it has remained at this level. Despite the high slippages, the overdue loan book remains a monitorable with the 60-90 days past due (dpd) at 4.5% of the micro loan book as on December 31, 2020. The proforma net non-performing advances (NPAs) stood at 2.36% as on December 31, 2020.

While the impact of the loan waiver remains a monitorable, similar announcements in other geographies could pose a challenge for the bank. In a stress case scenario of a full provision on 50% of the micro loans in the 60-90 dpd category as well as 10% of the micro loan portfolio in Assam and on the proforma net NPAs, ICRA expects that the bank shall be able to absorb such credit costs through its operating profitability without impacting its capital position. ICRA expects the credit provisions to remain high even in Q4 FY2021 as BBL is likely to make further provisions for the overdue portfolio in FY2021 itself. This will moderate the profitability in FY2021 but the same shall improve from FY2022 if the stressed book does not increase because of the tail impact of the pandemic and the emerging impact of the loan waiver.

BBL's micro loan portfolio continues to have high geographical concentration with more than 60% of this portfolio concentrated in the eastern and north-eastern regions of India driven by 64% of the branch network in these regions as on December 31, 2020. This exposes the bank to event risks and economic conditions in these geographies. Although the share of Emerging Entrepreneurs Business (EEB) group-based loans (erstwhile MFI loans) reduced to 59.5% of the total loans as on December 31, 2020 from 86.2% as on March 31, 2019 driven by BBL's merger with GRUH Finance Limited (GRUH), it remains high. ICRA will continue to monitor the bank's asset quality profile with several states expected to have elections in 2021.

The Stable outlook on the rating factors in ICRA's expectation that the bank will be able to absorb the credit losses through its operating profits while maintaining/improving its capital and solvency position. The outlook also factors in BBL's strong liquidity profile with an excess statutory liquidity ratio (SLR) of 13.7% of net demand and time liabilities (NDTL) as on November 6, 2020 and a strong daily average liquidity coverage ratio (LCR) of 131% for Q3 FY2021.

ICRA has withdrawn the rating on BBL's Rs. 30.00-crore non-convertible debentures (NCDs) as the same have been fully redeemed and there is no amount outstanding against the rated instrument. The rating has been withdrawn as per ICRA's policy on the withdrawal and suspension of credit ratings.

Key rating drivers and their description

Credit strengths

Strong capital position to provide cushion against expected losses – BBL reported core equity capital (CET I) and a capital adequacy ratio (CRAR) of 21.42% and 26.17% (29.20% including 9M FY2021 profits), respectively, as on December 31, 2020, well above the minimum regulatory requirement and peer banks. The capital position has been supported by the strong profitability on account of the bank's presence in high-yielding loan segments, translating into relatively higher net interest margins (NIMs), thereby driving its internal capital generation and supporting its capital profile.

The strong capital position is likely to provide a cushion against the expected credit losses if they were to rise, given the uncertainty regarding the asset quality because of the pandemic and the announcement of loan waivers. In a stress case scenario as mentioned earlier, the capital ratios and leverage will remain strong and the Tier I is expected to remain above 20% with the leverage below 6.0-7.0 times (4.85 times as on December 31, 2020).

Operating profitability remains strong but driven by high-yielding riskier loan segments – The bank has a presence in the high-yielding EEB group segment, which accounted for 59.5% of its overall advances as on December 31, 2020. The overall yield on advances stood at 15.47% in 9M FY2021 (18.35% in 9M FY2020), thereby translating into robust NIMs and strong operating profitability. While BBL's operating profitability is strong, its presence in the micro loan segment with a marginal borrower profile exposes the net profitability to episodic events like floods and political/socio-economic instability, which could lead to higher credit costs. This is reflected in the sharp jump in the proforma gross and net NPAs to 7.12% and 2.36%, respectively, as on December 31, 2020 (1.48% and 0.58%, respectively, as on March 31, 2020). Despite the surge in the credit provision in 9M FY2021, BBL reported a return on assets [(RoA; net profit after tax/average total assets (ATA)] of 2.8% and a return on equity (RoE) of 17.3% in 9M FY2021 compared to 4.7% and 25.5%, respectively, in 9M FY2020. As per ICRA's estimates of a stress case, the bank should be able to absorb a sizeable share of the credit losses through its operating profits without impacting its capital.

Strong liquidity profile; ability to grow/maintain deposits with lower rates remains to be seen – ICRA notes that the sequential pace of deposit growth for the bank slowed down from Q4 FY2020, given the risk aversion of depositors towards some private banks after the failure of a private bank in March 2020. BBL witnessed a healthy YoY growth in total deposits as on December 31, 2020, mainly driven by a significantly high growth in savings deposits. As a result, it reported a high current account and savings account (CASA) ratio of 42.87% as on December 31, 2020 compared to 34.31% as on December 31, 2019. Despite a track record of just five years as a bank, BBL's retail deposits (CASA + retail term deposits) accounted for 81.0% of the total deposits as on December 31, 2020. BBL reduced its savings deposit rate to 3.0% w.e.f. September 7, 2020 from 4.0% earlier for daily balances up to Rs. 1 lakh. However, it continues to offer a high savings rate of 6.0% for daily balances above Rs. 1 lakh and up to Rs. 10 crore. Hence, the bank's ability to grow/maintain deposits with lower rates remains to be seen. As a result, BBL's cost of funds remained higher at 6.5% than the private banks' average of 4.9% in H1 FY2021. However, BBL's cost of funds declined to 6.0% in Q3 FY2021 from 6.5% in Q2 FY2021.

The bank's liquidity is supported by a high share of priority sector loans (PSL) and a PSL-compliant portfolio, which supports its ability to generate liquidity. BBL can avail refinancing facilities from All-India Financial Institutions (AIFIs) against its PSL portfolio, which depends on its net worth and the net worth of the lending AIFI. As per the management, the bank can avail up to Rs. 20,000 - 25,000 crore of such refinancing facilities against which the borrowings from these AIFIs stood at less than Rs. 12,000 crore as on December 31, 2020. BBL can also sell these PSL portfolios through interbank participatory certificates (IBPCs), which can generate liquidity if required. Notwithstanding these short-term liquidity enhancers, the stability and steady growth in the deposit base will be a driver of the liquidity in the long term and will remain a monitorable.

Long track record in microfinance segment and high share of PSLs aid better profitability – Prior to its conversion into a bank, BBL's ultimate parent company, i.e. Bandhan Financial Services Private Limited (BFSL), had a long track record in providing microfinance loans. Consequently, the bank has high customer vintage, loyalty and a strong connect with its micro loan customers. It has demonstrated resilient asset quality during credit events such as demonetisation and the Assam agitation. GRUH also had a track record of strong asset quality through business cycles in mortgages despite lending to the relatively vulnerable lower income self-employed segment.

BBL has a high share of a PSL-compliant portfolio, which enables it to sell priority sector lending certificates (PSLCs). PSLC income is a significant contributor to the overall non-interest income (NOI; 29.3% of total NOI in FY2020), which supports the bank's RoE and internal capital generation. However, this source of income may be vulnerable to any unfavourable regulatory development on PSL norms for banks and the improved ability of other banks to organically grow their PSL, which could reduce BBL's income from such transactions.

Credit challenges

Asset quality uncertainty remains despite large proforma slippages – As expected, Covid-19 has significantly impacted the bank's asset quality with proforma gross NPAs of 7.12% or (Rs. 5,513 crore) as on December 31, 2020 (1.48% as on March 31, 2020). This has also resulted in a surge in credit provisions and BBL has made a Covid-19 provision and additional standard asset provisions of Rs. 3,119 crore, adjusted for which the proforma net NPA was 2.36% as on December 31, 2020.

Despite a surge in proforma GNPAs, the asset quality remains a monitorable as the borrowers in the overdue category remain high. The proportion of micro loan customers paying on time stood at ~80% of the micro loan book while ~13% are paying part instalments (rest are a part of the proforma NPAs). Among the part-paying customers, borrowers in the 30-60 dpd and 60-90 dpd stood at 5.5% and 4.5%, respectively of the micro loans as on December 31, 2020 and are monitorable for future stress. The bank has not implemented restructuring in any account as of December 2020.

Apart from the pandemic-induced stress, the announcement regarding the waiver of micro loans in Assam by the state government in the run-up to the state elections has further impacted the borrower's credit discipline. In addition, the state government passed "Assam Micro Finance Institutions (Regulation of Money Lending) Bill, 2020", which is expected to increase the operational challenges in collections for BBL. The additional impact of the loan waiver announcement is a 10% decline in the collection efficiency in the Assam portfolio (78% collection post announcement vs. 88% earlier). About 14% of the bank's micro loan portfolio is in Assam and it can absorb the incremental 10% stress as a loss through its operating profitability. However, a similar announcement in other states heading into elections, especially West Bengal, will be a credit negative for the bank.

BBL's borrowers in the micro loan segment are among the weaker sections of society and are highly vulnerable to political appeasement. The bank will remain exposed to event risks and the losses upon default are expected to be very high, given the unsecured nature of lending.

High geographical concentration of loan and deposit portfolio – While BBL has increased its pan-India presence across 34 states and Union Territories (UTs), 64% of the branches were in the eastern and north-eastern regions as on December 31, 2020. Owing to the concentration of the branch network, the bank's advances have high geographical concentration in the eastern and north-eastern regions of India, specifically West Bengal (46% of MFI loans) and Assam (14%). Also, the retail deposits remain concentrated with the eastern and north-eastern regions of India accounting for 67% of the total retail deposits. This exposes the bank to event risks and economic conditions, especially in these geographies. Meanwhile, GRUH has a presence in 11 states and one UT through 195 GRUH centres, most of which are in the western part of India. ICRA expects the portfolio concentration to continue in these regions in the medium term, given the size of the existing portfolio and the branch network.

Liquidity position: Strong

Despite collections remaining below the pre-Covid level, the bank reported a positive cumulative gap across all the maturity buckets as per the structural liquidity statement as on September 30, 2020. BBL's stable deposit profile, coupled with the short tenure of micro loans (12-24 months), largely supported its strong liquidity profile. BBL had excess SLR securities of ~Rs. 9,633 crore (13.7% of NDTL), as on November 6, 2020, that can be sold to meet its liquidity requirements. Moreover, the bank's ability to avail refinance and undertake IBPC transactions, given that a large share of its portfolio qualifies for PSL, enhances its liquidity. BBL's daily average LCR remained high at 131% for Q3 FY2021 against the peak regulatory requirement of 100% from April 1, 2021.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the bank is able to diversify and reduce its concentration in the microfinance portfolio to less than 20% of the total portfolio, control the delinquencies and maintain a strong capital position while achieving growth.

Negative factors – ICRA could downgrade the ratings if the loan book under moratorium does not decline substantially in the coming months, thereby increasing the risk for the asset quality and the capital. This apart, a material weakening in the bank's deposit franchise, thereby impacting its resource profile, will be a negative trigger. A deterioration in the capital ratios with the Tier I capital ratio below 15% and a rise in the leverage level above 8.0 times (including IBPCs) on a consistent basis will also be negative triggers.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[ICRA Rating Methodology for Banks](#) [Policy on Withdrawal of Credit Ratings](#)
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financials of the BBL

About the company

The erstwhile Bandhan Financial Services Private Limited (BFSL) was the largest non-banking financial company – microfinance institution (NBFC-MFI) in India and the first entity to receive an in-principle universal banking licence from the Reserve Bank of India. Following the transfer of BFSL's business to the bank, Bandhan Bank Limited (BBL) commenced operations in August 2015.

BBL was incorporated in December 2014 as a wholly-owned subsidiary of Bandhan Financial Holdings Limited (BFHL). On August 3, 2020, BFHL diluted its shareholding in BBL to 40% to comply with the regulatory requirement regarding promoter holding in the bank. BFHL's stake was diluted to 82.28% upon the initial public offer by BBL in March 2018 and later to 60.96% upon the amalgamation with GRUH in October 2019. BFHL is now required to further reduce its shareholding in the bank to 15% by August 2027.

BFSL holds 100% equity in BFHL. BFSL's shareholders are Financial Inclusion Trust (FIT): 32.91%, Caladium Investment Pte Ltd.: 16.7%, International Finance Corporation: 13.59%, IFC FIG Investment Company: 2.85%, Bandhan Employee Welfare Trust: 14.61%, SIDBI: 8.13%, North East Financial Inclusion Trust (NEFIT): 7.82%, and individuals: 3.4%. FIT and NEFIT are trusts formed in FY2009 with corpus donations from Bandhan Konnagar, the NGO from which the microfinance portfolio was transferred to BFSL. The beneficiaries of these trusts are the public and the trustees are industry professionals.

BBL is headquartered in Kolkata and follows the group-based individual lending model for the microfinance business. In 2019, the amalgamation of GRUH (housing finance company) with BBL was completed. GRUH has a presence in 11 states and 1 UT through 195 GRUH centres, most of which are in the western part of India. As on December 31, 2020, BBL had a network of 5,197 branches, banking units or doorstep service centres (DSCs) and GRUH centres, spread across 34 states and UTs.

Key financial indicators

Bandhan Bank	FY2019^	FY2020	9M FY2020	9M FY2021
Net interest income	4,496	6,324	4,644	5,806
Profit before tax	3,013	4,053	3,360	2,813
Profit after tax	1,952	3,024	2,506	2,102
Net advances	39,643	66,630	60,601	76,775
Total assets	56,442	91,718	84,791	1,07,297
% CET I	27.88%	25.19%	23.09%	21.42%
% Tier I	27.88%	25.19%	23.09%	21.42%
% CRAR	29.20%	27.43%	24.69%	26.17%
% Net interest margin	8.93%	8.54%	8.63%	7.78%
% PAT / ATA	3.87%	4.08%	4.66%	2.82%
% Return on net worth	17.42%	19.90%	25.52%	17.25%
% Gross NPAs	2.04%	1.48%	1.93%	7.12%&
% Net NPAs	0.58%	0.58%	0.81%	2.36%&
% Provision coverage	72.14%	60.78%	58.42%	67.13%&
% Net NPA/ Core equity capital	2.14%	2.62%	4.06%	12.00%&

Note: *Amount in Rs. crore; All calculations are as per ICRA research*
Total assets and net worth exclude revaluation reserves
^ The data for FY2019 excludes GRUH while FY2020 data is for the merged entity (including GRUH)
& Proforma numbers including the proforma NPAs and standstill slippages as directed by the Hon'ble Supreme Court
Quarterly results are unaudited; annual results are audited
Source: *Bandhan Bank, ICRA research*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Feb 22, 2021 (Rs. crore)	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019		Date & Rating in FY2018
					Feb 24, 2021	Aug 10, 2020	Nov 11, 2019	Mar 14, 2019 Jan 8, 2019	Oct 4, 2018 Apr 10, 2018	Feb 5, 2018
1	Subordinated Tier II NCD	Long Term	160.00	160.00	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA &	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
2	Senior Secured NCD	Long Term	100.00	Nil	-	-	-	-	-	[ICRA]AA- (Stable); withdrawn
3	Term Loans from Banks*	Long Term	80.00	Nil	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA &	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
4	Certificates of Deposit	Short Term	3,000.00	894.58^	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Non-convertible Debenture Programme	Long Term	196.40	196.40	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable); Assigned	-	-	-
6	Non-convertible Debenture Programme	Long Term	30.00	0.00	[ICRA]AA (Stable); reaffirmed and withdrawn	[ICRA]AA (Stable)	[ICRA]AA (Stable); Assigned	-	-	-

** **Note:** The rating is yet to be allocated*

^ Data as on February 22, 2021

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE545U08019	Subordinated Tier II NCD	Sep-02-2014	14.536%	Sep-02-2021	160.0	[ICRA]AA (Stable)
NA	Term Loans from Banks*	NA	NA	NA	80.0	[ICRA]AA (Stable)
NA	Certificates of Deposit	NA	NA	7-365 days	3,000.0	[ICRA]A1+
INE580B07455	Non-convertible debentures^	Oct-30-2018	9.50%	Oct-30-2028	75.0	[ICRA]AA (Stable)
INE580B07489	Non-convertible debentures^	Nov-28-2018	9.18%	Mar-29-2022	86.4	[ICRA]AA (Stable)
INE580B07497	Non-convertible debentures^	Dec-06-2018	9.35%	Oct-31-2023	35.0	[ICRA]AA (Stable)
INE580B07430	Non-convertible debentures^	Sep-27-2017	7.40%	Sep-30-2020	30.0	[ICRA]AA (Stable); reaffirmed and withdrawn

**Note: The rating is yet to be allocated; ^ These NCDs were transferred to BBL from erstwhile GRUH Finance Limited as a part of the amalgamation*

Source: *Bandhan Bank, ICRA research*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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