Bandhan Bank Limited

April 10, 2018

Summary of Rated Instrument:

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Subordinated Tier II NCD	160.00	160.00	[ICRA]AA(Stable); Upgraded from [ICRA]AA- (Positive)
Term Loans from Banks	80.00	80.00	[ICRA]AA(Stable); Upgraded from [ICRA]AA- (Positive)
Certificate of Deposit	1,500.00	1,500.00	[ICRA]A1+; Reaffirmed
Total	1,740.00	1,740.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded its long-term rating to [ICRA]AA (pronounced ICRA double A) to the Rs. 160-crore subordinated Tier-II non-convertible debenture programme and its Rs. 80-crore term loans of Bandhan Bank Limited (BBL). The outlook on the rating has been changed to stable from positive earlier. ICRA has also reaffirmed BBL's short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the certificates of deposit programme of Rs. 1,500 crore.

Rationale

Earlier in February 2018, ICRA had reaffirmed its long-term rating of [ICRA]AA- (pronounced ICRA double A minus) and revised the outlook on long-term rating to Positive which could be upgraded upon the successful completion its proposed initial public offer (IPO) of equity shares. BBL has successfully completed its IPO of equity shares during March 2018 and has received fresh capital of ~Rs. 3,662 crore. Consequently BBL's capital base has strengthened further as the Tier I capital is estimated to increase to ~40% as compared to 23.53% as on December 31, 2017, which will further improve the loss absorption capability against any unforeseen events.

The ratings continue to factor in healthy growth in gross advances (including IBPCs[1] and assignments) at 32.7% YoY as on December 31, 2017 with a major share of its advances qualifies for priority sector lending - PSL (96.5% as on December 31, 2017) as compared to regulatory requirements of 40%. This helps the bank generate significant income by selling PSL certificates and entering into IBPC transactions and provides flexibility for capital management and liquidity if required. ICRA takes note of BBL's improving liability profile with high level of deposits mobilised by the bank within a short period of commencement of operations. The retail deposits accounted for 85.1% as on December 31, 2017 from 37.95% as on March 31, 2016. BBL's high yield micro loan segment and PSL income, coupled with lower cost of funds due to a high proportion of retail deposits resulted in high return ratios as compared to the industry average. Despite healthy portfolio growth, BBL was able to maintain strong capitalisation levels with a CRAR of 24.85% as on December 31, 2017 driven by strong internal accruals. BBL's liquidity profile remains comfortable with no negative cumulative asset liability mismatch (ALM) gap in any of the maturity buckets driven by a short tenure of 12 months of micro loans. The ratings continue to be supported by the bank's experienced management team and strong investor profile.

[1] IBPCs – Inter Bank Participatory Certificates

The rating is constrained by the marginal borrower profile, which are also vulnerable to political appeasement such as temporary moratorium on loan repayments post demonetisation was construed as loan waivers and consequently pose risks to asset quality. Concentration risks in terms of assets and liabilities also remains high with 72.4% of the overall loan portfolio and 52.4% of the deposits concentrated in the states of West Bengal, Assam and Bihar as on September 30, 2017, which makes it vulnerable to event risks and economic conditions in these geographies. ICRA has taken note of some weakening in the asset quality, post demonetisation, with gross NPAs rising to 1.67% (as on December 31, 2017) as compared to 0.48% (as on December 31, 2016). However, the asset quality has remained comfortable with the gross NPA ratio better than the MFI industry average of ~10% as on December 31, 2017.

Outlook: Stable

ICRA expects the bank to maintain stable credit profile driven by its strong internal capital generation to support growth while maintaining strong capitalisation levels. The outlook may be revised to Negative if there is deterioration in the asset quality profile of the bank resulting in pressure on profitability and capital levels.

Key rating drivers

Credit strengths

Comfortable asset quality driven by robust loan-monitoring and collection mechanisms - Despite its conversion into a bank, BBL continues to follow its established practices of group lending such as group meetings and weekly collections for its MFI loans, which helps it to closely track the loan portfolio. BBL compulsorily checks the credit bureaus records and arranges field visits before considering a loan, which mitigates the risk of loan origination. As a result, gross NPAs to gross advances (excluding IBPC/Assignment) was at 1.67% as on December 31, 2017 from 0.48% as on December 31, 2016 driven by a rise in fresh NPA generation rate to 1.62% as on December 31, 2017 from 0.38% as on December 31, 2016. The weakening of asset quality has been driven by the after effects of demonetisation, loan waiver in a few states and the goods and services tax (GST) implementation, which resulted in liquidity shortage and a decline in credit discipline. However, the gross NPA ratio of the bank remains better than the MFI industry average of ~10% as on December 31, 2017 driven by a good loan origination process, incremental sanctions being done post credit bureau checks, post-disbursement loan utilisation checks and strong internal audit processes.

Leveraging steady growth in priority sector lending portfolio coupled with diversification into retail and SME lending segments - By virtue of a sizeable share of its loan portfolio from microfinance borrowers (88% as on December 31, 2017), the bank has a unique advantage as a significant proportion of its advances qualify for priority sector lending (96.5% as on December 31, 2017) as compared to regulatory requirements of 40%. Its micro loans grew by 27.2% YoY during 9M FY2018. This helped the bank generate income by selling PSL certificates and entering into Inter-Bank Participation Certificate (IBPC) transactions. During 9M FY2018, BBL sold PSCLs worth Rs. 14,954 crore and executed IBPC transactions of Rs. 3,000 crore. It reported a gain of Rs. 293.6 crore from its IBPC transactions and an income from sale of PSLCs of Rs. 147 crore in 9M FY2018. Apart from leveraging its micro portfolio, the bank is expanding into other retail and SME segments products such as personal loans, home loans, loans against property, two-wheeler, gold loans, MSME among others. The other segments accounted for 11.7% of the total portfolio as on December 31, 2017 as compared to 8.0% as on December 31, 2016.

Deposit mobilisation gains traction with focus on retail deposits; however, deposit concentration remains high - Following its conversion into a bank, BBL has successfully mobilised a sizeable amount of its deposits. BBL's deposit base increased to Rs. 25,294 crore (90.9% of outside liabilities) as on December 31, 2017 from Rs. 19,463 crore as on December 31, 2016 even though it commenced operations in August 2015. The bank's low cost CASA deposits also increased to Rs. 8,402 crore (33.2% of total deposits) as on December 31, 2017 from Rs. 5,297 crore (27.2% of total deposits) as on December 31, 2016. Within the CASA deposits of 6,837 crore as on March 31, 2017, Rs. 1,802 crore (26% of CASA deposits) were from microfinance borrowers. Further, the bank continued to focus on retail term deposits with its share increasing to 51.9% as on December 31, 2017 from 38.1% as on December 31, 2016 while the wholesale term deposits declined drastically from 34.7% as on December 31, 2016 to 14.9% as on December 31, 2017. Overall, the retail deposits, including the CASA deposits increased to 85.1% of the total deposits as on December 31, 2017 from 37.95% as on March 31, 2016. BBL's expanding branch network at 3,520 as on December 31, 2017 and maturation of old branches led to an improvement in its deposit base. Additionally, strong interest margins enable the bank to offer higher deposit rates on its savings deposit accounts and help mobilise deposits. While the bank's deposit mobilisation has been healthy, the deposits remain concentrated with 44.1% being sourced from West Bengal and 18.6% from Maharashtra as on September 30, 2017. The substantial increase in low cost CASA, decline in wholesale term deposits and fall in high cost borrowings led to a consistent decline in the bank's cost of interest-bearing funds to 6.47% during 9M FY2018 from 7.32% during 9M FY2017. This enabled the bank to lower its lending rates, resulting in the yield on advances declining from 18.5% in 9M FY2017 to 16.7% in 9M FY2018.

Strong profitability indicators – BBL reported a return on net worth of 23.6% during 9M FY2018 from 25.0% in FY2017 as compared to the MFI industry average of a negative ROE during 9M FY2018. The net profit to average total assets remains strong at 3.9% in 9M FY2018 as compared to 4.4% FY2017. The return ratios are supported by high net interest margins at 8.8% during 9M FY2018 from 9.6% in FY2017 which is higher than the MFI industry average. BBL's yield on average advances declined to 16.7% in 9M FY2018 from a high of 21.4% in FY2016, which is in-line with a decline in its benchmark MCLR rates. The fall in benchmark MCLR rates was driven by a decline in the funding cost of the bank. While the bank has higher yielding advances these are the lowest compared to other micro loan lenders and the higher yields reflects the high operating costs associated with origination and monitoring of these loans, apart from the riskiness of the borrowers, which are from the weaker section.

Capitalisation profile remains strong, further strengthened after IPO – Despite a healthy YoY growth of 32.7% in advances as on December 31, 2017, the bank's capitalisation levels remain strong with CRAR at 24.85% as on December 31, 2017 as compared to 28.67% as on December 31, 2016 and is way above the minimum regulatory requirement of 13% for new banks. Further, as per the RBI's New Bank Licensing Guidelines, a bank should get listed within three years from the date of commencement of business. Consequently, BBL was listed on March 19, 2018 and has raised fresh capital of ~Rs. 3,662 crore. As a result, the capitalisation profile of the bank has strengthened with Tier I capital is estimated to increase to ~40% as compared to 23.53% as on December 31, 2017. The solvency profile of the bank remains strong with net NPA to net worth of 3.41% as compared to PVBs average of 13.2% as on December 31, 2017.

Comfortable liquidity profile - The ALM profile of the bank remains comfortable with no negative cumulative ALM gap in any of the maturity buckets. A bulk of the micro loans has a short-term tenure of 12 months providing liquidity comfort. In addition, BBL's ability to undertake IBPCs transactions, given that a majority of the portfolio qualifies for PSL can also generate liquidity if required. BBL had an excess SLR of around Rs. 4,400 crore as on September 29, 2017 adding to the liquidity of the bank. The liquidity coverage ratio of the bank remains comfortable at 127.28% as on December 31, 2017 as against the regulatory requirement of 90% as on January 01, 2018.

Strong investor and experienced promoter profile - BBL is headed by Mr. Chandra Shekhar Ghosh (MD & CEO of BBL) who has more than 35 years of experience in the microfinance industry. Further, the bank has a strong management team with nine independent directors and two nominee directors out of the 13 directors on the board. The directors have a strong knowledge and prior experience in either the microfinance or the banking industry. Additionally, BBL is backed by strong domestic and foreign investors such as the Small Industries Development Bank of India (SIDBI), International Finance Corporation (IFC) - private equity arm of the World Bank, Caladium Investment - an affiliate of GIC (Singapore's sovereign wealth fund).

Credit challenges

High geographical concentration in the East and North-east - BBL's portfolio is highly concentrated in eastern and north-eastern regions of India which accounted for 58.7% and 22.2% respectively of the total portfolio as on September 30, 2017. Within these regions, the state of West Bengal, Assam and Bihar collectively accounted for 72.4% of total portfolio and 52.4% of total deposits as on September 30, 2017 which is similar to the previous year. The high portfolio concentration is because of a large concentration of branches and DSCs at around 67% and 69% respectively as on September 30, 2017. This exposes the bank to concentration risks arising due to regional factors like natural calamities, political unrest, rising competition amongst others. However, the low rural credit deposit ratio of SCBs in these states as compared to all India rural average also provides a huge opportunity for BBL to tap the untapped potential market.

Lack of track record across new credit segments and other products – BBL has gradually diversified its loan portfolio to the non-micro loans segments such as SME, retail and small enterprise loans (SEL) which collectively accounted for 11.7% of the total loan portfolio as on December 31, 2017 as compared to only 1% as on March 31, 2016. Despite gradual diversification into other loan products, the borrowers largely remain micro borrowers. Also, BBL does not have any track record across new loan products and services which might act as a challenge in growing these segments.

Marginal borrower profile – The profile of the borrower remains marginal who are highly vulnerable to political appeasement and consequent risks on asset quality. Asset quality was negatively impacted post demonetisation in November 2016 across states. In some states, a temporary moratorium on loan repayments after demonetisation was construed as loan waivers, thereby resulting in a rise in delinquency levels. BBL will remain exposed to such event risks.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

ICRA Rating Methodology for Banks

About the company:

The erstwhile Bandhan Financial Services Pvt. Ltd. (BFSL) was the largest 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). BFSL holds 100% of equity in BFHL. The shareholders of BFSL are Financial Inclusion Trust (FIT): 32.91%, Caladium Investment Pte Ltd.: 16.7%, International Finance Corporation: 16.44%, Bandhan Employee Welfare Trust: 14.61%, SIDBI: 8.13%, North East Financial Inclusion Trust (NEFIT): 7.82%, and individuals (including promoters): 3.4%. FIT and NEFIT are trusts formed in FY2009 with corpus donations from Bandhan Konnagar, the NGO whose microfinance portfolio was transferred to BFSL. The beneficiaries of these trusts are public, and the trustees are industry professionals.

BBL is headquartered in Kolkata and has two divisions – general banking and microfinance lending. The shareholders of BBL include BFHL: 89.62%, International Finance Corporation: 3.21%, Caladium Investment Pte Ltd.: 4.99%, IFC FIG Investment Company: 1.73%, and SIDBI: 0.32% and Mr. Chandra Shekhar Ghosh: 0.13%. BBL follows the group-based individual lending model for microfinance, forming groups of 10 to 20 women in close proximity. A group elects its own treasurer, cashier and secretary on a rotational basis from within.

BBL operates through a network of 3,520 branches and DSCs, spread across 33 states and Union Territories. BBL's portfolio stood at Rs. 24,364 crore as on December 31, 2017 reporting an annualised 32.7% growth during 9M FY2018. Its asset quality indicators remained comfortable with gross NPA of 1.67% as on December 31, 2017. BBL charges an interest rate with reference to MCLR on its microfinance loan products.

Key financial indicators (audited)

	FY2016*	FY2017	9MFY2017	9MFY2018
Net Interest Income	933	2,403	1,714	2,169
Profit Before tax	414	1,704	1,211	1,461
Profit After tax	275	1,112	790	958
Net Advances	12,438	16,839	16,223	22,931
Total Assets	19,757	30,236	25,952	33,219
%CET 1	26.72%	24.77%	26.85%	23.53%
%Tier 1	26.72%	24.77%	26.85%	23.53%
% CRAR	29.01%	26.36%	28.67%	24.85%
%Net Interest Margin / Average Total Assets	10.57%	9.62%	9.06%	8.81%
%Net Profit / Average Total Assets	3.12%	4.45%	4.18%	3.89%
%Return on Net Worth	14.15%	25.01%	25.53%	23.63%
% Gross NPAs	0.15%	0.51%	0.48%	1.67%
% Net NPAs	0.08%	0.36%	0.38%	0.80%
% Provision Coverage incl. Technical Write-offs	45.44%	29.09%	21.46%	52.34%
% Net NPA/ Net Worth	0.31%	1.38%	1.48%	3.41%

Amounts in Rs. crore
All ratios are as per ICRA's calculation
*Note: BBL's data for FY2016 is for the period August 23, 2015 to March 31, 2016.
Source: Bandhan Bank; ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017		Date & Rating in FY2016
					April 2018	February 2018	February 2017	December 2016	December 2015
1	Subordinated Tier II NCD	Long Term	160.00	160.00	**[ICRA]AA (Stable)**	**[ICRA]AA- (Positive)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**
2	Senior Secured NCD	Long Term	60.00	Nil	-	-	-	**Withdrawn**	**[ICRA]AA-; (Stable)**
3	Senior Secured NCD	Long Term	100.00	Nil	-	**Withdrawn**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**
4	Term Loans from Banks*	Long Term	80.00	-	**[ICRA]AA (Stable)**	**[ICRA]AA- (Positive)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**
5	Certificate of Deposit	Short Term	1,500.00	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

*Note: The rating is yet to be allocated

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	02-Sep-14	14.536%	02-Sep-21	160.00	[ICRA]AA (Stable)
NA	Term Loans from Banks*	NA	NA	NA	80.00	[ICRA]AA (Stable)
NA	Certificate of Deposit^	NA	NA	7-365 days	1,500.00	[ICRA]A1+

*Note: The rating is yet to be allocated

Source: Bandhan Bank; ICRA research

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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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