August 10, 2020

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
Non-convertible Debenture Programme	226.40	226.40	[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
Non-convertible Debenture Programme	1,350.00	0.00	[ICRA]AA (Stable); reaffirmed and withdrawn
Total	**4,816.40**	**3,466.40**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation considers Bandhan Bank Limited's (BBL) strong operating profitability and capital position, which are likely to provide a cushion against the expected losses that may arise on account of the expected stress on the asset quality following the Covid-19 pandemic. Despite a rise in the collection efficiency over the last two months, the asset quality remains uncertain because of the pandemic with the bank reporting that 24% of its overall advances were under repayment moratorium as on June 30, 2020. While this may result in increased credit costs in FY2021, even in a scenario of a final loss of 6-8%, BBL's capital position is expected to remain strong with Tier I of over 21.0% by March 2021. ICRA notes that the sequential pace of deposit growth slowed down from Q4 FY2020 onwards, given the risk aversion of depositors towards some private banks (PVBs). However, BBL's deposit base remains stable with a high share of retail deposits. Additionally, a higher share of the bank's portfolio qualifies for priority sector lending (PSL)[1], which enables it to avail refinancing facilities from All India Financial Institutions (AIFIs). This apart, BBL held excess statutory liquidity ratio (SLR) investments of ~Rs. 7,094 crore (11.7% of net demand and time liabilities - NDTL) as on July 3, 2020, and had a strong daily average liquidity coverage ratio (LCR) of 129%[2] for Q4 FY2020.

While the capital position, the operating profitability and the liquidity profile remain strong, the share of micro loans (63.9% of the overall loan book as on June 30, 2020), though reducing, remains high despite BBL's merger with GRUH Finance Limited (GRUH). Moreover, the micro loan portfolio has high geographical concentration in the eastern and north-eastern regions of India, which accounted for more than 60% of the micro portfolio as on June 30, 2020, thus exposing it to event risks and economic conditions in these geographies. Despite a rise in the collection efficiency post the easing of lockdown restrictions, 30% of the micro loans were under moratorium as on June 30, 2020 and will drive asset quality stress in the coming quarters. The bank has made voluntary Covid-19 provisions of Rs. 1,440 crore (8.6% of overall loan under moratorium) till June 30, 2020. ICRA expects that these

[1] *Of the overall advance, 90% was PSL compliant as on June 30, 2020 against the regulatory requirement of 40%*

[2] *Against the revised RBI guidelines of LCR requirement of 80% from April 17, 2020 to September 30, 2020, 90% from October 1, 2020 to March 31, 2021 and 100% from April 1, 2021 onwards compared to the earlier regulatory requirement of 100% as on January 1, 2019*

provisions could increase further if the loan book under moratorium does not decline substantially and will result in weak profitability in FY2021. ICRA will continue to monitor the bank's asset quality profile and ability to reduce the loan book under moratorium. Additionally, the stability in the deposit profile and the bank's ability to maintain a strong liquidity position will remain near-term monitorables.

Additionally, ICRA has withdrawn the rating on BBL's Rs. 1,350.00-crore non-convertible debentures (NCDs) as the same have been fully redeemed and there is no amount outstanding against the rated instrument. The rating was 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 23.22% and 26.45% (27.29% including Q1 FY2021 profits), respectively, as on June 30, 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 bank's internal capital generation and supported its capital profile.

The strong capital position is likely to provide a cushion against the expected credit losses if they were to arise because of the uncertainty regarding the asset quality, given the high share (24%) of the overall loan book under moratorium. In an extreme stress case scenario of a final loss of 6-8%, as per ICRA's estimates, the capital ratios and leverage will remain strong and the Tier I is expected to remain above 21% with the leverage below 6.0 times. The bank also reported a marginal increase in the leverage with Total debt/Net worth at 4.90 times as on June 30, 2020 compared to 3.94 times as on June 30, 2019, post amalgamation with GRUH.

Operating profitability remains strong but driven by high-yielding riskier loan segments – The bank has a presence in the high-yielding microfinance loan segment, which accounted for 63.9% of its overall advances as on June 30, 2020. The overall yield on advances stood at 15.38% for Q1 FY2021 (17.85% for FY2020), thereby translating into strong 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.

The recent lockdown, which was imposed to prevent the spread of the pandemic, had impacted the bank's collection efficiency with 0% collections in the micro loan segment in April 2020. Though the collection efficiency improved to 76% in value terms in June 2020 from 29% in April 2020 on the overall loan portfolio, BBL made additional Covid-19 provisions of Rs. 690 crore and Rs. 750 crore, respectively, in Q4 FY2020 and Q1 FY2021. These provisions amount to 8.6% of the loan portfolio under moratorium and 2.1% of the total advances as on June 30, 2020. ICRA expects that these provisions could rise further if the loan book under moratorium does not decline. These provisions are not utilised towards the existing non-performing advances (NPAs) and the bank has the cushion to utilise these in case the delinquencies increase post the moratorium period. Despite the rise in the credit provision in Q1 FY2021, BBL reported a return on assets (RoA; net profit after tax/ATA) of 2.3% and a return on equity (RoE) of 14.2% in Q1 FY2021 compared to 4.1% and 19.9%, respectively, in FY2020.

Strong liquidity profile; however, deposit base remains monitorable – ICRA notes that the sequential pace of deposit growth slowed down from Q4 FY2020 onwards, given the risk aversion of depositors towards some PVBs. The deposit base, however, stabilised with 6.2% QoQ growth in Q1 FY2021. Despite a track record of just five years as a bank, BBL's retail deposits (CASA + retail term deposits) accounted for 77.7% of the total deposits as on June 30, 2020. Notwithstanding the high share of CASA deposits and retail deposits, ICRA notes that the bank has limited overlap between its assets and liability customers and hence its liability relationship is also driven by the higher interest rate offered on deposits. As a result, the cost of funds for BBL stood higher at 6.6% than the PVBs' average of 5.2% in Q4 FY2020.

Apart from the stable deposit base, the bank's liquidity is supported by a high share of PSL and a PSL-compliant portfolio, which supports its ability to generate liquidity. BBL can avail refinancing facilities from AIFIs against its PSL portfolio, which depends on its net worth and the net worth of the lending AIFI. As discussed with the management, the bank can avail up to Rs. 20,000 - 25,000 crore of such refinancing facility against which the borrowings from these AIFIs stood at Rs. 12,417 crore as on June 30, 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 priority sector loans also aid in 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 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). The 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, given high share of loan book under moratorium and marginal borrower profile – In the backdrop of the pandemic and the high level of physical collections involved in micro loans, the bank reported almost nil collections in micro loans and overall collections of 29% on the loan portfolio in April 2020. With the relaxation in the lockdown conditions in May and June 2020, the collection efficiency increased across all segments with overall collections of 76% in value terms at the end of June 2020. As the moratorium is available till August end, a sustained improvement in the collections remains to be seen. This, along with the high level of the moratorium book and the slowdown in economic activity, has created significant uncertainty regarding the asset quality of 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 a default are expected to be very high, given the unsecured nature of the lending. Driven by the moratorium on loan repayment, the fresh NPA generation was low in Q1 FY2021 compared to FY2020. The asset quality profile remained comfortable with Gross and Net NPAs of 1.43% and 0.48%, respectively, as on June 30, 2020. Given the unprecedented situation, the asset quality outlook remains uncertain and will depend on a return to normalcy from the pandemic situation.

High geographical concentration of loan portfolio – While BBL has increased its pan-India presence across 34 states and Union Territories (UTs), 60% of the branches, as on June 30, 2020, were in the eastern and the north-eastern regions. 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 and Assam. 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. Therefore, the geographical diversification and incremental advances sourcing are expected to improve for BBL from the recent levels. Though the incremental growth in other regions is higher than the eastern and north-eastern regions, 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

Even though a substantial part of the loan book is under moratorium, stability in the deposit base has imparted a strong liquidity profile to the bank. BBL had excess SLR securities of ~Rs. 7,094 crore (11.7% of NDTL), as on July 3, 2020, that can be sold to meet its liquidity requirements. Moreover, BBL'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 129% for Q4 FY2020 against the peak regulatory requirement of 100% from April 1, 2021 onwards.

Rating sensitivities

Positive triggers – 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 triggers – 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 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 ICRA Policy on Withdrawal and Suspension of Credit Rating
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 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). 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 June 30, 2020, BBL had a network of 4,559 branches, Banking Units or Door Step Service Centers (DSCs) and GRUH centres, spread across 34 states and UTs.

Key financial indicators

	FY2019^	FY2020	Q1 FY2020*	Q1 FY2021
Net Interest Income	4,496	6,324	1,575	1,812
Profit before tax	3,013	4,053	1,230	735
Profit after tax	1,952	3,024	804	550
Net advances	39,643	66,630	41,486	69,749
Total assets	56,442	91,718	58,668	97,117
%Tier I	27.88%	25.19%	23.65%	23.22%
% CRAR	29.20%	27.43%	26.58%	26.45%
%Net Interest Margin / Average total assets	8.93%	8.54%	8.60%@	7.67%
%Net Profit / Average total assets	3.87%	4.08%	4.20%@	2.33%
%Return on Net Worth	17.42%	19.90%	24.30%@	14.22%
% Gross NPAs	2.04%	1.48%	1.70%@	1.43%
% Net NPAs	0.58%	0.58%	0.59%@	0.48%
% Provision coverage excl. technical write-offs	72.14%	60.78%	65.92%	66.64%
% Net NPA/ Net worth	2.04%	2.56%	3.03%	2.13%

Amounts in Rs. crore
^ The data for FY2019 is excluding GRUH while FY2020 data is for the merged entity (including GRUH)
** The profit and loss account data for Q1 FY2020 is for the merged entity (including GRUH) while the balance sheet data is for standalone BBL*
@These ratios for Q1 FY2020 are sourced from BBL's Q1 FY2021 presentation
The profitability ratios for Q1 FY2020 and Q1 FY2021 are annualised
Quarterly results are unaudited; annual results are audited
All ratios are as per ICRA's calculation
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)				Rating History for the Past 3 Years					
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019				FY2018
					10-Aug-2020	11-Nov-2019	14-Mar-2019	8-Jan-2019	4-Oct-2018	10-Apr-2018	5-Feb-2018
1	Subordinated Tier II NCD	Long Term	160.00	160.00	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA &	[ICRA]AA &	[ICRA]AA (Stable)	[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 &	[ICRA]AA &	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
4	Certificates of Deposit	Short Term	3,000.00	1,859.71^	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Non-convertible Debenture Programme	Long Term	226.40	226.40	[ICRA]AA (Stable)	[ICRA]AA (Stable); Assigned	-	-	-	-	-
6	Non-convertible Debenture Programme	Long Term	1,350.00	-	[ICRA]AA (Stable); reaffirmed and withdrawn	[ICRA]AA (Stable); Assigned	-	-	-	-	-

Amount in Rs. crore

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

^ Data as on June 30, 2020

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	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	160.0	[ICRA]AA (Stable); reaffirmed
NA	Term Loans from Banks*	NA	NA	NA	80.0	[ICRA]AA (Stable); reaffirmed
NA	Certificates of Deposit	NA	NA	7-365 days	3,000.0	[ICRA]A1+; reaffirmed
INE580B07455	Non-convertible debentures^	30-Oct-18	9.50%	30-Oct-28	75.0	[ICRA]AA (Stable); reaffirmed
INE580B07489	Non-convertible debentures^	28-Nov-18	9.18%	29-Mar-22	86.4	[ICRA]AA (Stable); reaffirmed
INE580B07497	Non-convertible debentures^	6-Dec-18	9.35%	31-Oct-23	35.0	[ICRA]AA (Stable); reaffirmed
INE580B07430	Non-convertible debentures^	27-Sep-17	7.40%	30-Sep-20	30.0	[ICRA]AA (Stable); reaffirmed
INE580B07455	Non-convertible debentures^	30-Oct-18	9.50%	30-Oct-28	75.0	[ICRA]AA (Stable); reaffirmed
INE580B07372	Non-convertible debentures^	17-Nov-16	7.57%	17-Nov-19	500.0	[ICRA]AA (Stable); reaffirmed and withdrawn
INE580B07380	Non-convertible debentures^	21-Mar-17	7.58%	20-Mar-20	500.0	[ICRA]AA (Stable); reaffirmed and withdrawn
INE580B07398	Non-convertible debentures^	24-Mar-17	7.68%	23-Mar-20	315.0	[ICRA]AA (Stable); reaffirmed and withdrawn
INE580B07430	Non-convertible debentures^	27-Sep-17	7.40%	30-Sep-20	35.0	[ICRA]AA (Stable); reaffirmed and withdrawn

**Note: The rating is yet to be allocated; ^ These Non-Convertible debentures 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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