Stock Update

Bandhan Bank Ltd.

April 22, 2022

RETAILRESEARCH

Bandhan Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – Pvt. Bank	Rs 336	Buy in Rs 335-340 band & add more on dips to Rs 293-298 band	Rs 369	Rs 405	2 quarters

HDFC Scrip Code	BANBANEQNR
BSE Code	541153
NSE Code	BANDHANBNK
Bloomberg	BANDHAN IN
CMP Apr 21, 2022	336.4
Equity Capital (Rs cr)	1610.8
Face Value (Rs)	10
Equity Share O/S (cr)	161.1
Market Cap (Rs cr)	54702
Book Value (Rs)	96.1
Avg. 52 Wk Volumes	82,70,000
52 Week High (Rs)	354.4
52 Week Low (Rs)	229.6

Share holding Pattern % (Mar, 2022)	
Promoters	40.0
Institutions	38.9
Non Institutions	21.1
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Bandhan Bank (BBL) has posted strong results during Q3FY22 with growth across parameters. Along with growth, there is improvement in asset quality and collection efficiencies. Business is expected to reach to pre-covid levels soon with strong demand for credit and continued improvement in collection efficiency. Many of the NPA customers have regularized their overdue account and we expect this to continue for a couple of quarters. BBL also expects to receive funds from the Assam Microfinance Incentive & Relief Scheme which could elevate the accounts to standard category and reduce its stressed pool. It has so far not considered Assam relief recovery benefit in its assumption of provisioning requirement. Bank's recovery (and business) generally is best in Q4; and the same is expected in Q4FY22 as well.

Valuation & Recommendation:

We expect loan book to grow at CAGR of ~17% over FY21-FY24E and RoA/RoE to normalize by FY24E as asset quality improves. Yields are likely to improve on NPA reversals. BBL carries a large provisioning which may be reversed partly boosting the profitability, capital adequacy and book value. Microfinance sector is seeing revival in growth and fall in delinquencies. BBL currently trades at 2.3 FY24E P/ABV which is attractive in our view, given the potential in the coming years. We have valued the bank at 2.5x FY24E ABV for a base case target of Rs 369 and 2.75x FY24E ABV for a bull case target of Rs 405 over 2 quarters. Investors can buy the stock at in the band of 335-340 and add on dips to Rs 293-298 (2x FY24E ABV).

Financial Summary

Particulars (Rs cr)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	FY21	FY22E	FY23E	FY24E
NII	2125	2072	*2.6*	1935	*9.8*	7563	8388	9560	11558
PPoP	1950	1914	*1.9*	1549	*25.9*	6855	7169	7844	9185
PAT	859	633	*35.8*	-3009	*NA*	2205	141	4008	5143
EPS (Rs)	5.3	3.9	*36.0*	-18.7	*NA*	13.7	0.9	24.9	31.9
P/E (x)						24.6	385.6	13.5	10.5
P/ABV (x)						3.7	3.5	2.8	2.3
RoAA (%)						2.1	0.1	2.9	3.1

(Source: Company, HDFC sec)

Q3FY22 Result Update

BBL reported strong performance in Q3FY22 with PPoP growing by 23% QoQ to Rs 1950cr. Interest income grew by 7% QoQ while interest expenses were up by 3.1% as cost of funds continued to contract and stood at 5.2% (down 10/80 bps QoQ/YoY). NIM expanded marginally by 20bps QoQ to 7.8% on improvement in yields to 12.6%. Provisions were lower by 25% YoY to Rs 806cr after the bank took a significant provision in Q2FY22 of ~Rs 5600cr. PAT grew by 36% YoY to Rs 859cr on account of lower provisioning.

Advances grew 8/5% QoQ/YoY as disbursals grew 32%/61% YoY/QoQ. Incremental disbursements were driven predominantly by non-EEB (Emerging Entrepreneurs Business) segments, in line with management guidance of portfolio diversification (Group EEB share of the portfolio to reach 30% by FY25). EEB-individual's share in the portfolio continued to inch up steadily to 14% (Q3FY21: 6%), while the mix of housing and commercial segments remained largely stable. Deposit growth came in at 18.7% YoY, aided by 26% YoY uptick in CASA. As a result, CASA ratio improved to 45.6% vs. 44.6% QoQ. This ratio is one of the best among the private sector Banks.

The bank witnessed a sharp reduction in early delinquency buckets of its EEB portfolio (~1000bps reduction in 1-60dpd buckets) and restructured pool (~Rs 1730cr). The decline in overall restructured book to Rs 6600cr from Rs 9000cr) was led by recoveries. However, the total stressed pool of its EEB portfolio (SMA-II+ GNPA+ restructured) remains sticky at 27% of loans (Q2FY22: 29%), indicating stubbornness of high-vintage stressed assets. GNPA/NNPA stayed largely steady at 10.8/3.0%, but on an absolute basis GNPA was up 7.7% QoQ. No incremental restructuring was seen during the quarter.

Q4 Business Update

- Gross advances (on/off the book and TLTRO investments) increased by 16/15% YoY/QoQ to Rs 1.01 lakh crore, supported by a likely improvement in disbursements.
- Total deposits increased by 24% YoY to Rs 96,331cr driven by 32% growth in bulk deposits to Rs 21,890cr. Growth in CASA deposits moderated to 18/4% YoY/QoQ resulting in 400bps decline in CASA ratio to 41.6%.
- Overall collection efficiency (excluding arrears, including NPA customers) for the month of March 2022 improved to 96%. Collection efficiency in the EEB portfolio stood at 95% while in the non-EEB portfolio was 98%. Excluding NPA accounts collection efficiency was back to pre COVID levels of 99%.

Key Triggers

Microfinance's contribution to India's GVA likely to grow

The microfinance sector contributed about 2% of India's gross value added (GVA), while the overall contribution of the entire financial sector was ~5.5% in 2018-19, according to a study by the National Council of Applied Economic Research (NCAER). It said the contribution of the microfinance sector is significant to the economy with all its forward and backward linkages and its potential to create jobs.

The economic research body predicted that the overall microfinance sector is slated to contribute, including the backward and forward linkages 3.52% of GVA under the best case scenario. The sector's contribution may grow to 2.7% under base case while it may shrink to 1.54% under pessimistic scenarios.

India Ratings in Feb 2022 has revised upwards its outlook on the microfinance sector to 'neutral' from 'negative' this fiscal, on the back of a revival in growth that could clip at 30%. The agency expects the sector to grow 20-30% in both FY22 and FY23 in comparison to the below 10% AUM (assets under management) growth in the previous two years. BBL being amongst the largest lender for the sector is likely to benefit from the strong growth of the microfinance industry.
The agency expects the credit cost to decline to a median of 1.5-5 per cent in FY23 from 4-7 per cent in FY22 as collections are better since December and it will be lower than FY22. The decline would largely be a function of growth, provision coverage and recovery from restructured loans.

Easing of microfinance regulations by RBI
The Reserve Bank of India (RBI) in March 2022 has removed the interest rate ceiling on loans offered by microfinance institutions (MFIs) while making a few other sweeping changes to put all microfinance lenders including banks, small finance banks, NBFC and not-for-profit companies on a uniform regulatory platform. The RBI also raised the annual household income to Rs 3 lakh for a collateral-free loan to be classified as microfinance loan. So far, such loans given to households with an annual income of Rs 1.25 lakh in rural India and Rs 2 lakh in urban and semi-urban areas were classified as microfinance loans. With this change, unsecured loans by several other non-banking finance companies will also be considered as micro loans. All such loans, irrespective of the end-use, will come under this classification. The revised rules for microfinance loans focus on harmonising norms for lenders and deregulating norms for NBFC-MFIs.

The margin cap on lending rates was introduced a decade back to stop NBFC-MFIs from charging usurious rates. The RBI has now offered freedom in fixing board-approved lending rates, but warned that those should not be usurious and that the rates would come under its supervisory scrutiny. MFIs may be able to undertake risk-based pricing as well as cost-plus pricing, leading to improved viability of small and medium players and aid them in building both scale and operating buffers, and increase their credit worthiness.

Bandhan Bank received approval to accept Government business on behalf of the RBI as an Agency Bank
BBL has been authorised by RBI in Oct 2021 as an Agency Bank of the RBI for undertaking Government business. The appointment would allow BBL to undertake Government business on behalf of the RBI. With this, the bank joins ranks with a few other scheduled private sector banks to be empanelled as Agency Banks of the RBI. As an agency bank of the RBI, authorised to undertake government business, the bank will be able to handle transactions related to collection of state taxes and revenue receipts such as the GST and VAT; collection of stamp

duty and pension payments on behalf of the central and state governments. BBL has a strong branch network in eastern and north-eastern parts of India and in semi-urban/rural areas. With the Agency Bank authorisation its business could increase in a big way.

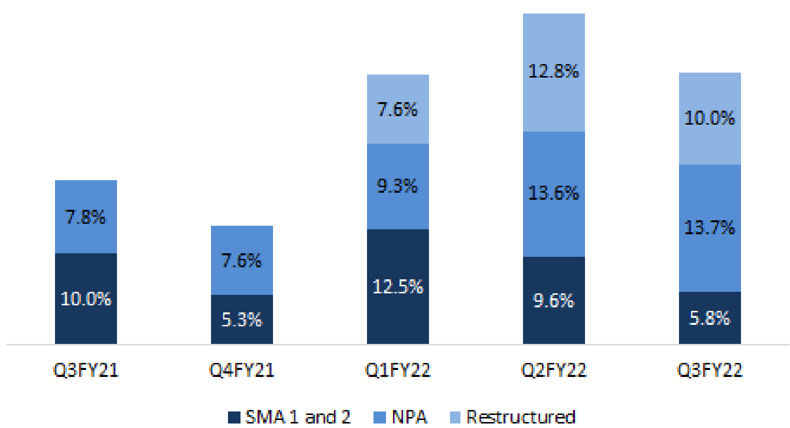
Overall stress has started to come down

The Covid pandemic resulted in sharp increase in stressed assets as many of the borrowers were unable to pay. Post the expiration of RBI relaxation for NPA classification during the pandemic, stress levels started to increase. As a result, the bank made a provision of ~Rs 5600cr as overall stressed assets increased to 36% in Q2FY22. The impact of third wave was negligible and the bank has started to witness improved collection efficiencies. BBL currently has overall stressed assets of 27% of advances. While the SMA 1 and 2 assets and restructured assets have seen an improvement, assets classified as NPA still remain elevated.

The bank expects ~Rs 5000cr of recoveries from its stressed EEB portfolio by Jun'22. According to the management, the bank has sufficient provision against the current stressed assets and would not require any further provisioning. Reducing stress and provision reversal could be a positive surprise and aid improved profitability in the coming quarters. Restructured book declined to ~Rs 6600cr from ~Rs 9000cr in Q2FY22 as recoveries improved. There was no incremental restructuring in Q3FY22.

Under Credit guarantee fund, the bank expects recovery of Rs 2500cr (vs Rs 3000cr in Sept-21) as the stress pool has reduced. Bank will place this claims to govt. after 31st March.

Total stressed assets started to decline



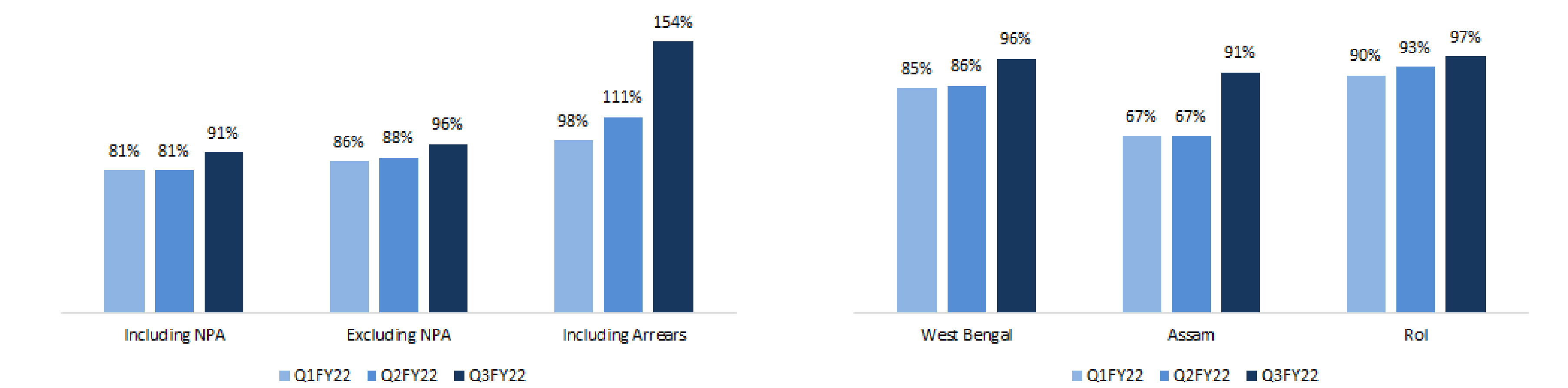
(Source: Company, HDFCsec)

Although the amount cannot be ascertained, BBL continues to get money under the Assam relief scheme. Bank has received for 39600 accounts (Std. pool) worth ~Rs 86cr. Government has taken overdue customers data from Bank and bureau and BBL expects to get money in a quarter or so. The Assam Govt. in its state budget of 2022-23, has earmarked Rs 2500cr towards Assam Microfinance Incentive & Relief Scheme. BBL has exposure of Rs 6000cr in Assam of which 23.4% is NPA, 5.7% in SMA-2 pool, 3.1% in SMA-1 and 30% restructured as of Dec'21.

Collection efficiencies showing improvement

Collection efficiencies for the bank have reached pre-pandemic levels. Even in the higher stressed states of West Bengal and Assam collection efficiency has been above 90% in Q3FY22. Overall collection efficiencies including arrears stood at 154% in Q3FY22 indicating that many of the customers are paying their instalments including past dues. This is significant as until all overdue amount are not recovered the account is not categorized as non- NPA customers. This will lead to decline GNPA.

Improving trend in collection efficiencies

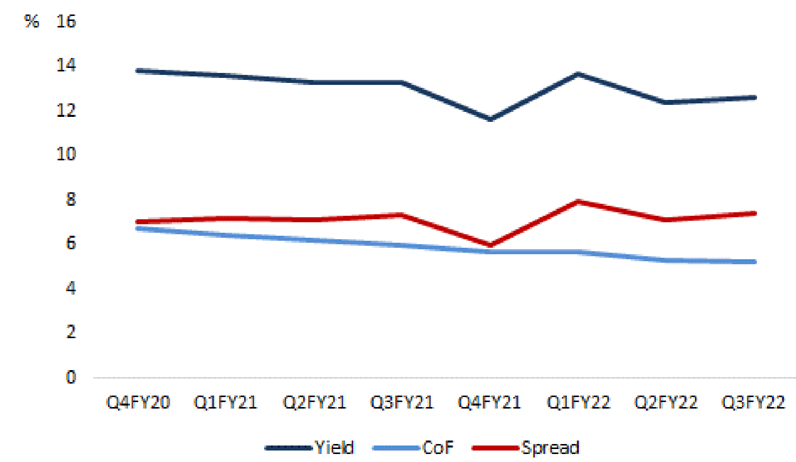


(Source: Company, HDFCsec)

Interest spread not impacted, supporting NIMs

Despite the pandemic, BBL has not witnessed any significant impact on its interest spreads. Although the yields have declined from ~14% in FY20 to 12.6% in Q3FY22, cost of funds has also contracted by 170bps to 5.2%. We believe, reversals of NPA classification would lead to improvement in yields in the near term and provide a cushion as the bank moves towards its intended target of 70% non-MFI loans by FY25.

Interest spread has remained largely stable



(Source: Company, HDFCsec)

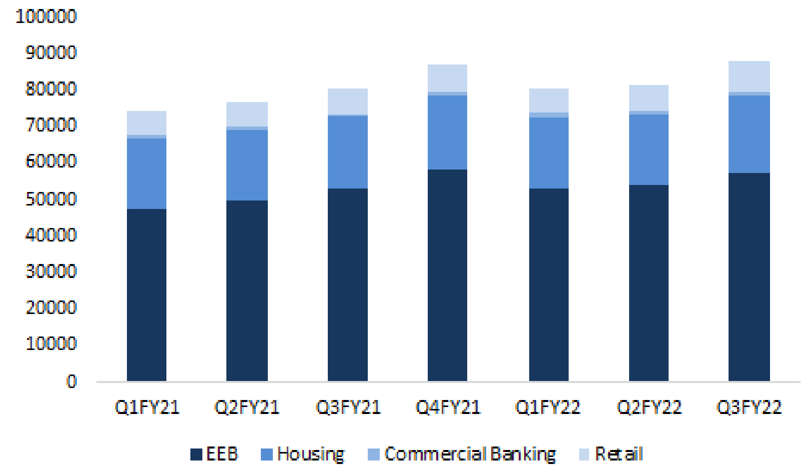
Bandhan-led consortium acquires IDFC's mutual fund business

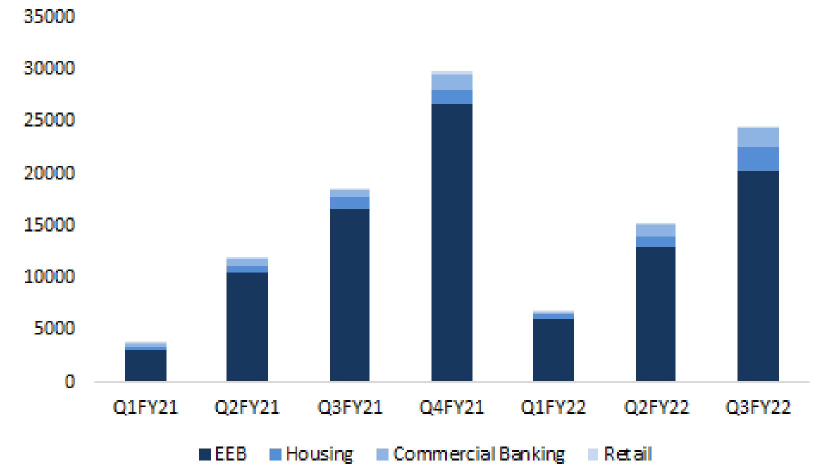
Bandhan Financial Holding-led consortium has entered into a definitive agreement to acquire IDFC Asset Management Company and IDFC AMC Trustee Company for Rs 4,500 crore, subject to receipt of necessary regulatory approvals. The consortium led by it also includes private equity firm ChrysCapital and Singapore's sovereign fund GIC. In the consortium, the equity pattern is 60% for Bandhan Financial Holding (parent of BBL) and 20% each for the other two partners. Although BBL itself sells products from some 8-10 mutual funds currently, this acquisition could result in higher fee income in the future.

Diversification in lending book

BBL has been reducing its dependence on MFI loans and diversifying its asset book. Prior to the acquisition of Gruh, MFI book accounted for 86% of its advances. From 2020, BBL is following a five-year business roadmap with a target to increase the housing loan share to total assets to 30% while the share of microfinance group loans will reduce to 30% and the share of MSME plus individual loans (those who graduated from group loans) will also be 30%. The balance 10% will be retail book other than housing.

Advances and Disbursement breakup (Rs cr)





(Source: Company, HDFCsec)

Risks & Concerns

Competition from peers and new entrants

BBL faces competition from large private sector banks in building up its deposit franchise and improving CASA ratio. Private banks are also focusing on scaling up their deposit base. Also Banks and new MFIs are expanding their activities in Microfinance bringing competition for BBL. BBL offers higher interest rate on savings account to shore up its CASA ratio. If and when it cuts this rate, it could impact the CASA balances.

Political risks due to nature of loans

Loan book of BBL is still dominated by microfinance loans. Political instigation in some of the states asking people not to pay back their dues, as witnessed in the past, could result in higher NPAs. BBL has huge dependence and concentration in East and North east region for its MFI business. Any unexpected event or natural catastrophe in these regions can impact its growth and asset quality.

Changes in regulatory requirement

BBL's business could be directly affected by any changes in policies for banks with respect to directed lending, reserve requirements, provisioning and other areas. Also if there is a margin cap on the MFI lending, BBL's profits could get impacted.

Non collateral loans

Microloans are not generally backed by collateral, they may pose a higher degree of risk than loans secured with physical collateral.

Higher slippages in some states

MFIs in states such as Assam, Bengal and Kerala, and specific districts of Maharashtra and Gujarat where there was delayed easing of lockdown restrictions under both the Covid waves along with other regional issues could result in higher slippages, especially those accounts that have been provided longer moratoriums.

Lending to high risk borrowers

BBL caters to SME and low income group customers which are the most impacted during economic setback. Restructuring and SMA book can create negative surprise in case economy does not recover sustainably.

Industry Overview

- As on December 31, 2021, the microfinance industry served 5.57 crore unique borrowers, through 10.58 crore loan accounts. The overall microfinance industry currently has a total Gross Loan Portfolio (GLP) of INR 2,56,058 crores.
- GLP as on December 31, 2021, showed an increase of 10.1 per cent YoY over INR 2,32,648 crores as on December 31, 2020.
- As on 31 December 2021, 13 Banks hold the largest share of portfolio in micro-credit with total loan outstanding of Rs 1,03,569 Cr, which is 40.4% of total micro-credit universe. NBFC-MFIs are second largest provider of micro-credit with a loan amount outstanding of Rs 87,444 Cr, accounting for 34.2% to total industry portfolio. SFBs have a total loan amount outstanding of Rs 42,847 Cr with total share of 16.7%. NBFCs account for another 7.6% and Other MFIs account for 1.1% of the universe.
- The microfinance active loan accounts increased by 0.8% during the past 12 months to 10.58 crores as on December 31, 2021.
- In terms of regional distribution of GLP, East & Northeast and South account for 65% per cent of the total portfolio.

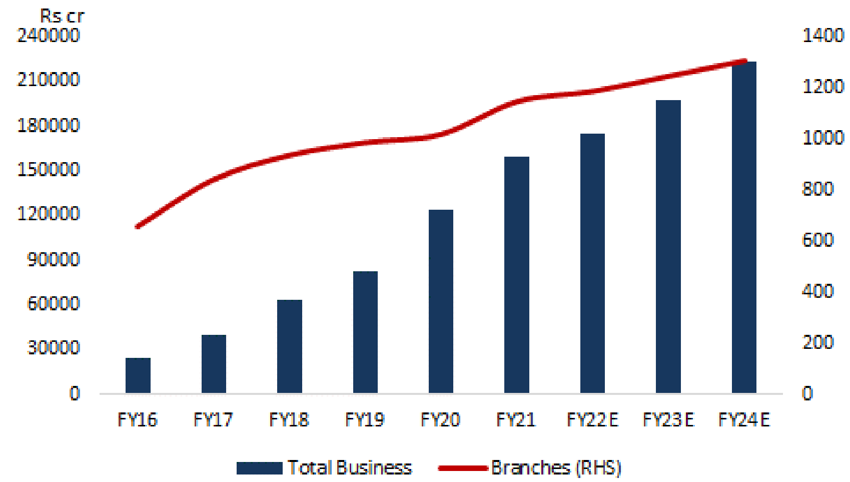
Company Background:

Set up as Bandhan Financial Services Pvt. Ltd (BFSL) in 2006, BFSL was the largest NBFC-MFI in India until 2014 post which, it became the first entity to receive an in-principle universal banking license from the Reserve Bank of India. After it commenced operations in August 2015, BFSL's entire microfinance portfolio was transferred to Bandhan's book. The bank is headquartered in Kolkata and offers group-based individual lending services for the microfinance business.

In 2019, the bank acquired Gruh with the dual objective of reducing the promoter shareholding to the stipulated level and to diversify operations both geographically and across asset classes. Bandhan Financial Holdings Ltd. (BFHL), the parent company of BBL, is now required to further reduce its shareholding in the bank to 15% by August 2027, from the current 40%.

Expanding progressively over the years, BBL delivers product and service excellence to ~2.3cr customers in 34 states/UTs, through its 5,626 (as of Dec'21) banking outlets.

Outstanding loan book growth



(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	10885	12524	13839	15889	19114
Interest Expenses	4562	4961	5451	6329	7555
Net Interest Income	**6324**	**7563**	**8388**	**9560**	**11558**
Non interest income	1549	2109	2259	2632	3024
Operating Income	**7873**	**9672**	**10647**	**12192**	**14583**
Operating Expenses	2427	2817	3478	4348	5398
PPoP	**5447**	**6855**	**7169**	**7844**	**9185**
Prov & Cont	1393	3907	6977	2353	2140
Profit Before Tax	4053	2949	192	5491	7045
Tax	1030	743	52	1483	1902
PAT	**3024**	**2205**	**141**	**4008**	**5143**

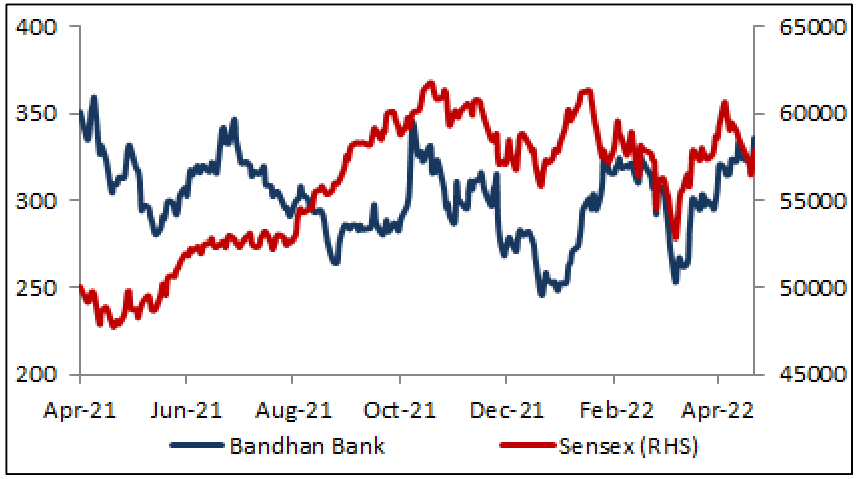
Balance Sheet

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	1610	1611	1611	1611	1611
Reserves & Surplus	13585	15798	15736	19203	23805
Shareholder funds	**15195**	**17408**	**17347**	**20814**	**25416**
Deposits	57082	77972	91287	110500	134511
Borrowings	16379	16960	16323	15685	15088
Other Liab & Prov.	3062	2652	3219	3687	4478
SOURCES OF FUNDS	**91718**	**114993**	**128175**	**150687**	**179493**
Fixed Assets	369	487	523	562	605
Investment	15352	25155	27771	30784	35141
Cash & Bank Balance	8353	6193	10516	11359	11899
Advances	66630	81613	88030	106459	130003
Other Assets	1014	1545	1336	1522	1845
TOTAL ASSETS	**91718**	**114993**	**128175**	**150687**	**179493**

Ratio Analysis

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Return Ratios (%)					
Yield on advances	17.9	14.7	14.0	14.0	14.0
Cost of funds	7.8	5.9	5.4	5.4	5.5
NIM	9.3	7.9	7.5	7.4	7.5
RoAE	22.9	13.5	0.8	21.0	22.3
RoAA	4.1	2.1	0.1	2.9	3.1
Asset Quality Ratios (%)					
GNPA	1.5	6.8	8.6	5.8	4.2
NNPA	0.6	3.5	2.1	1.5	1.3
Growth (%)					
Advances	68.1	22.5	7.9	20.9	22.1
Deposits	32.0	36.6	17.1	21.0	21.7
NII	40.7	19.6	10.9	14.0	20.9
PPoP	45.3	25.9	4.6	9.4	17.1
PAT	54.9	-27.1	-93.6	2752.7	28.3
Valuation Ratios					
EPS (Rs)	18.8	13.7	0.9	24.9	31.9
P/E (x)	17.9	24.6	385.6	13.5	10.5
Adj. BVPS (Rs)	91.9	90.3	96.0	119.5	147.4
P/ABV (x)	3.7	3.7	3.5	2.8	2.3
Dividend per share (Rs)	0.0	1.0	1.3	3.4	3.4
Dividend Yield (%)	0.0	0.3	0.4	1.0	1.0
Operating efficiency (%)					
Cost-average assets	3.3	2.7	2.9	3.1	3.3
Cost-income	30.8	29.1	32.7	35.7	37.0

Price chart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Jun-21
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Dec-21
Feb-22
Apr-22
Bandhan Bank
Sensex (RHS)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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