

BANDHAN BANK LIMITED

IPO Note

(SUBSCRIBE)

Analyst:
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12 March 2018

IPO details

Key Data	
Issue Opens	15-Mar-18
Issue Closes	19-Mar-18
Equity Shares Offered (in mn.)	119.28
QIB	Up to 50%
NIB	Min 15%
Retail	Min 35%
Face Value (Rs.)	10
Price Band (Rs.)	370-375
Max. Issue Size (Rs. mn)	44,730
Lot Size (Eq. Shares)	40 and multiple thereof

Valuation	@ Rs.370 per share	@ Rs.375 per share
Market Cap (₹ mn)	449,336	455,408
ROA	17.7%	17.7%
ROE	2.9%	2.9%
P/B	10.1	10.2
P/E	36.5	36.9

	Pre Issue		Post Issue [^]	
	# mn Shares	% Holding	# mn Shares	% Holding
Promoters	981.5	89.6%	959.9	79.0%
Public	113.7		113.7	9.4%
Offer For Sale			21.6	1.8%
New Issue			119.3	9.8%
Total	1,095.1	100.0%	1,214.4	100.0%

Object of the issue

- The object of the fresh issue is to augment Bank's Tier-I capital base to meet Bank's future capital requirements.
- General corporate purposes.

Recommendation

In relatively short span of time the bank has grown aggressively. Its strength lies in microfinance loans which has grown from 2,022 DSCs and 6.77 million micro customers to 2,633 DSCs and 9.86 million as on Dec'2017 from the period of transfer from BFSL. It had a robust growth in total income from ₹17,313 million to ₹43,201 million and PAT growth of ₹11,119 from ₹2,752 million for FY17 and FY16 respectively. Its cost to income ratio is better than HDFC bank and Axis bank and has the highest NIM in the industry.

On valuation front, upper issue price at 36.9x FY17 earnings is fairly at par with its peers and can be looked for further growth on back of its robust growth for long term. Therefore we recommend **SUBSCRIBE** over the issue.

Source: Red Herring Prospectus, Dealmoney Research

Fastest growing private bank

- ❑ Bandhan Bank (Bandhan) was incorporated in 2014 in Kolkata, West Bengal as a commercial bank focused on micro banking and general banking services.
- ❑ Its strength lies in microfinance, which includes a network of 2,022 doorstep service centres (“DSCs”) and 6.77 million micro loan customers that BFSI transferred to Bandhan, since then it has grown to 2,633 DSCs and 9.86 million micro loan customers as of December 31, 2017.
- ❑ Bandhan started general banking business on August 23, 2015 by opening a greenfield network of 501 bank branches and 50 automated teller machines (“ATMs”), which as of Dec’2017, has grown to 887 bank branches and 430 ATMs, together serving over 2.13 million general banking customers.
- ❑ Bandhan’s distribution network is particularly strong in East and Northeast India, with West Bengal, Assam and Bihar together accounting for 57.75% and 58.13% of its branches and DSCs, respectively, though its focus is to expand across India.
- ❑ It currently offers a variety of asset and liability products and services designed for micro banking and general banking. Its asset products consist of retail loans including a substantial portfolio of micro loans, as well as micro, small and medium enterprise (“SME”) loans and small enterprise loans.
- ❑ Since beginning banking operations, it has built a strong base of current account and savings account deposits, which together stood at ₹84,018.45 million as of December 31, 2017, a CASA ratio of 33.22%.
- ❑ In addition to its loan and deposit products, it also offers other banking products and services to generate non-interest income, these products and services include debit cards, internet banking, mobile banking, EDC-POS terminals, online bill payment services and the distribution of third-party general insurance products and mutual fund products.
- ❑ As of December 31, 2017, its deposits and Gross Advances (including IBPC/Assignment) stood at ₹252,939.56 million and ₹243,643.89 million, respectively. For the nine months ended December 31, 2017 and 2016, it had net interest margins (“NIMs”) of 9.86% and 10.34%, return on equity (“RoE”) of 25.55% and 27.88% and return on assets (“RoA”) of 4.07% and 4.39%, respectively (each on an annualised basis).

Source: Red Herring Prospectus, Dealmoney research

Strengths

- ❑ **Operating Model Focused on Serving Underbanked and Underpenetrated Markets:** It is focused on serving underbanked and underpenetrated markets in India. While its business model has transitioned over the years, operating as an NGO and then a non-bank finance company (“NBFC”) before becoming a bank, the provision of micro loans to women has remained the core focus. It reaches its micro loan customers largely through its extensive network of doorstep service centres (DSC), which are low overhead banking outlets located nearby its customers. As DSC’s are a cost effective means of reaching micro loan customers, who are generally underbanked.
- ❑ **Consistent Track Record of Growing a Quality Asset and Liability Franchise:** Across the phase of development from and NGO to NBFC to Bank, its micro loan business has consistently grown a quality asset base. Since it began its general banking business, it has grown to offer a broad and diversified range of asset and liability products to its customers, while maintaining strong asset quality. As of September 30, 2017, its percentage of Gross NPAs to Gross Advances (excluding IBPC/Assignment) (“NPAs”) were 1.43% of its portfolio.
- ❑ **Extensive, Low Cost Distribution Network:** It provides its customers accessible, simple, cost-effective and innovative financial solutions in a courteous and responsible manner. It designs products that cater to the specific needs of its customers, such as offering educational micro loans and healthcare micro loans. On the liability side, It offers a variety of daily deposits, recurring deposits, and other services so that its customers can realise their savings goals within the means available to them. It also seeks to pass on the benefits of its low cost of funds to its customers, and since becoming a bank have lowered its interest rates on micro loans from 22.4% to 21.0% in August 2015 to 18.52% to 18.40% in December 31, 2017.
- ❑ **Consistent Financial Performance and Robust Capital Base:** Its Net Interest Income in FY 2016 amounted to ₹9,328.36 million, while Net Interest Income in FY 2017 amounted to ₹24,034.98 million. Its net interest margin for the six months ended September 30, 2017 was 10.01%, while its return on assets and return on equity were 4.28% and 27.23%, respectively (each on an annualised basis). As of December 31, 2017 a statutory liquidity ratio (“SLR”), cash reserve ratio (“CRR”) and capital adequacy ratio (“CAR”) was 24.90%, 4.12% and 24.85%, as compared to requirements of 19.50%, 4% and 13%, respectively.

Source: Red Herring Prospectus, Dealmoney research

Future road ahead

- ❑ **Maintain focus on micro lending while expanding further into other retail and SME lending:** As India's largest micro lender in terms of overall advances as of March 2017 (according to CRISIL Research), it aims to maintain its leading position in the micro lending space while expanding further into other retail and SME lending in order to capitalise on growth opportunities in India's micro lending and banking industries.
- ❑ **Continue to strengthen its liability franchise:** It aims to strengthen its liability franchise with a particular focus on growing its deposit base in order to provide a stable, low-cost source of funding. Its primary focus for funding is to seek retail deposits, as opposed to wholesale deposits or other forms of funding. Since becoming a bank, it has consistently grown its deposit base, from nil when it began operations to ₹120,887.48 million, ₹252,939.56 million as of March 31, 2016, March 31, 2017 and December 31, 2017.
- ❑ **Boost share of non-interest income:** It intends to complement income from its core asset products with non-interest income from other sources in order to diversify its income stream and improve its margins. In particular, It will seek to leverage its strong PSL-compliant portfolio by increasingly selling PSL certificates to non-PSL compliant banks. Additionally, in 2017 it entered into arrangements to begin distributing third-party insurance products and third-party mutual funds, in return for which it receives a commission based upon the value of insurance product or mutual fund sold.
- ❑ **Enhance its digital platform to improve customer acquisition and retention and reduce costs:** It is continually investing to enhance its digital and technology platform as a means of driving enhanced customer satisfaction, enhanced customer retention and reduced costs. For example, it has established internet banking facilities, a mobile banking app, online and mobile payment modes for cashless payments, e-commerce payments through Verified by Visa and Rupay Pay Secure, and other online payment and other services.
- ❑ **Enhance retail banking systems and procedures to improve efficiency:** It intends to enhance its retail banking systems and procedures in order to improve its retail banking efficiency. Whereas the performance of its micro loan business and DSC network have been refined for over 15 years, as a comparatively new player in the general banking segment it is seeking to build that same level of refinement for its retail banking operations.

Source: Red Herring Prospectus, Dealmoney research

Peer Comparison

	Market Cap (₹ bn)	P/B	Advances (₹ bn)	NIM (%)	ROE (%)	ROA (%)	Net NPA (%)	Gross NPA (%)	Cost to Income	CASA(%)	P/E
Bandhan Bank Ltd.	455	10.1	168	9.86	2.9	17.7	0.36	0.51	36.3	33.22	36.9
Private Sector Banks											
Axis Bank Ltd.	1297	2.1	4209	3.28	6.76	0.64	2.56	5.28	41.0	51.41	35.14
HDFC Bank Ltd.	4807	4.1	6312	4.05	17.95	1.81	0.44	1.29	43.4	48.03	28.82
The Federal Bank Ltd.	185	1.8	806	2.80	9.76	0.79	1.36	2.52	53.4	32.82	18.66
RBL Bank Ltd.	191	4.3	336	2.59	12.18	1.02	0.97	1.56	53.4	21.98	32.57
IDFC Bank Ltd.	169	1.4	488	1.92	7.21	1.04	2.52	5.62	42.1	5.21	17.05
Public Sector Banks											
Andhra Bank	34	0.4	1401	2.75	1.67	0.08	7.72	14.26	44.0	29.33	12.68
UCO Bank	45	0.6	1094	2.12	-20.01	-0.78	10.9	20.64	50.7	31.40	NA
Union Bank Of India	80	0.5	2937	2.15	2.69	0.13	6.96	13.03	46.4	34.44	11.22
IDBI Bank Ltd.	187	0.9	1833	1.83	-26.28	-1.40	16.02	24.72	52.9	31.46	NA
Punjab National Bank	232	0.8	4521	2.37	3.60	0.19	7.55	12.11	39.2	41.82	16.53
State Bank Of India	2185	1.5	18262	2.59	6.97	0.41	5.61	10.35	47.8	44.57	54.83

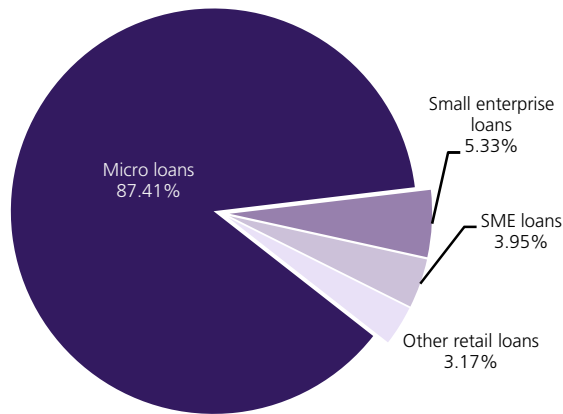
Comparison with NBFC's

	Market Cap (₹ mn)	P/B	Advances (₹ mn)	EPS ₹	ROE (%)	ROA (%)	P/E
Bandhan Bank Ltd.	455,408	10.1	168,391	8.74	2.9	17.7	36.9
AU Small Finance Bank Ltd.	168,265	7.67	13,739	28.77	55	10.23	20.47
Bajaj Finance Ltd.	954,717	6.05	99,774	41.09	21.7	3.16	40.2
Equitas Holdings Ltd.	47,434	2.81	123	0.17	0.36	0.35	812.22
Gruh Finance Ltd.	200,088	16.11	14,874	9.37	30.45	2.27	58.4
Ujjivan Financial Services Ltd.	41,186	2.36	11,455	0.37	14.07	5.24	924.07

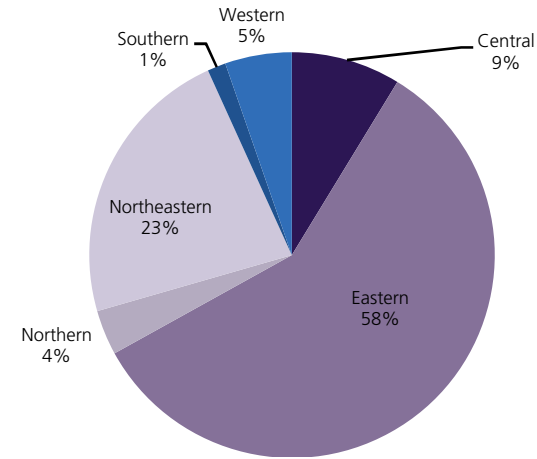
Source: Red Herring Prospectus, Dealmoney Research

Distribution of loans and advances

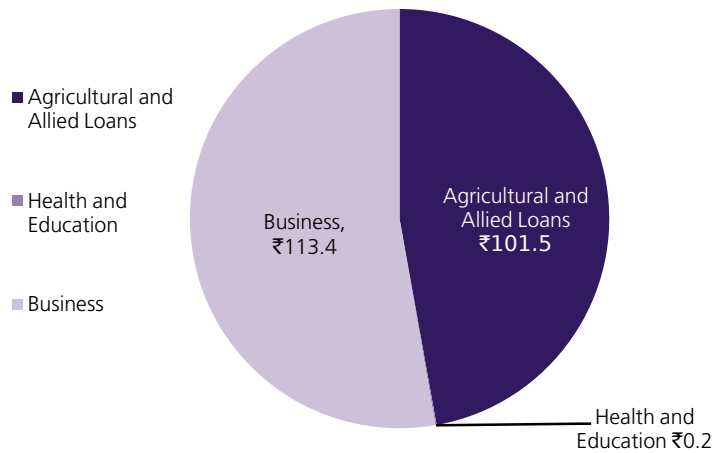
Net advances as of 31st Dec'17



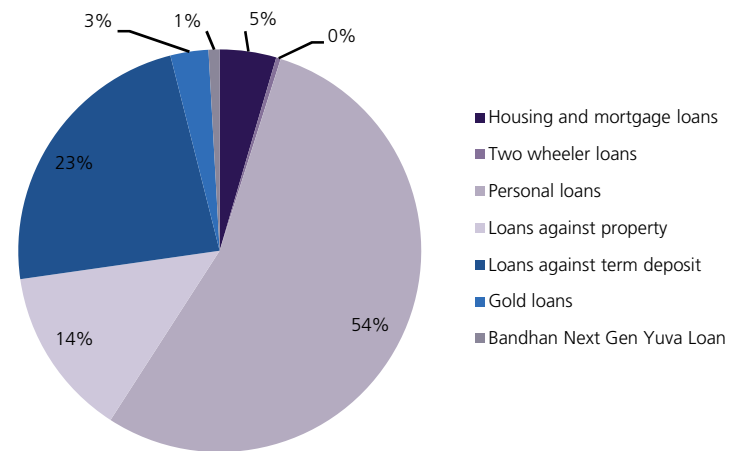
Regional distribution of gross advances as of 31st Dec'17



Microloan portfolio as of 31st Dec'17 (In ₹ bn)

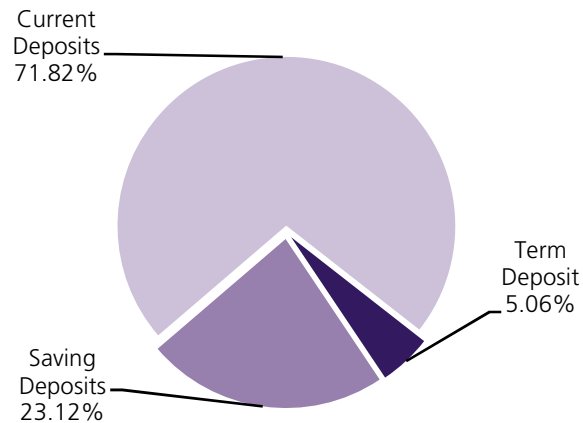


Other Retail Loans as of 31st Dec'17



Strong growth in deposits

Deposits Composition (Dec'17)



₹ mn	2016	2017	Dec'2017
Demand Deposits	2,346	14,526	14,853
Savings Deposits	23,711	53,847	69,165
Term Deposits	94,831	163,913	168,921
Total	120,887	232,287	252,940

- ❑ Casa constitutes 33.22% (as of Dec'2017) of the total deposits, which is among the best in the initial stages of any other new private banks.
- ❑ Gross Advances (including IBPC/Assignment) have grown from ₹155,784.35 million to ₹243,643.89 million as of December 31, 2017.
- ❑ Its deposits have grown from zero as of August 23, 2015, when it opened its general banking business, to ₹252,939.56 million as of December 31, 2017

Consolidated Summary Financials

Income Statement

₹ mn	Dec'FY18	FY17	FY16	FY15
Interest Earned	34,517	39,087	15,814	-
Other Income	5,028	4,114	1,499	80
Total	39,545	43,201	17,313	80
Expenditure				
Interest Expended	12,829	15,052	6,485	-
Operating Expenses	9,453	10,220	6,159	56
Provisions & Contingencies	2,651	884	533	-
Total	24,933	26,157	13,177	56
Profit before tax (I-II)	14,612	17,045	4,135	23
Current tax	5,414	6,252	1,695	26
Deferred tax credit	(379)	(327)	(313)	(9)
Total	5,035	5,925	1,383	17
Profit after tax as restated	9,577	11,120	2,752	6

Balance Sheet

₹ mn	Dec'FY18	FY17	FY16	FY15
Capital	10,951	10,951	10,951	5,011
Reserves & Surplus	43,090	33,513	22,394	6
Deposits	252,940	232,287	120,887	-
Borrowings	13,307	10,289	30,516	-
Other liabilities and provisions	11,905	15,320	12,816	253
Total	332,193	302,361	197,565	5,269
Assets				
Cash and balances with Reserve Bank of India	12,587	60,121	8,103	0
Balance with Banks and Money at call and short Investments	11,332	13,529	23,631	4,013
Advances	229,307	168,391	124,375	-
Fixed Assets	2,330	2,518	2,372	1,086
Other Assets	3,725	2,637	1,503	170
Total	332,193	302,361	197,565	5,269
Contingent liabilities	301	236	49	1,030
Bills for collection	-	-	-	-

Source: Red Herring Prospectus, Dealmoney research

Key Risks

- ❑ If Bandhan bank is unable to manage the growth associated with the expansion of its branches, ATMs and DSCs effectively, its financial, accounting, administrative and technology infrastructure, as well as its business and reputation could be adversely affected.
- ❑ A substantial portion of its operations are located in East and Northeast India, making it vulnerable to risks associated with having geographically concentrated operations.
- ❑ It derives a substantial portion of its interest income from advances that are due within one year, and a significant reduction in these short-term advances may result in a corresponding decrease in its interest income.
- ❑ Microcredit lending is risky and, as a result, it may experience increased levels of nonperforming loans and related provisions and write-offs that negatively impact its results of operations.

Source: Red Herring Prospectus, Dealmoney research

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