

Under Review

Bandhan Bank

Industry: BFSI

LKP
Since 1948**Strong quarter, but future promoter stake sale overhang remains!!!**

Bandhan bank showed strong performance in Q3 – operating profit grew by 57% yoy. However, provisions escalated since the bank provided 100% on its IL&FS exposure of ₹ 3.9 bn. This dragged down the PAT growth to 10% yoy although operationally it was strong quarter. AUMs continue to grow at sturdy pace at 46% yoy driven by both micro and non-micro loans while margins surged to 10.5% vs. 10.3% qoq. Despite RBI's restriction on future branch opening of the bank, leverage on the existing network continued – it added 9.2 lakh customers vs. 7.6 lakh in Q2, CASA inched upto 41.4% vs. 36.9% qoq, deposits grew by 37% yoy. Mgmt said it is not looking for another acquisition in the near term to dilute the promoter stake further.

Although the merger would result in long term synergies in terms of geographic distribution, product diversification, but in near term, it is book value dilutive. Another overhang will be to bring down the promoter stake further down from 61% levels capping any future upside on the stock. This will be one big negative for the bank over-riding its expected strong core future performance. For the same reason, we are keeping our current rating (TP of ₹ 760) on the stock "Under Review" till we revisit numbers on combined entity.

Operationally strong quarter, NPL provisions on IL&FS drag bottomline

Q3 was one of the strong quarter for the bank operationally – PPOP grew by 57% yoy led by healthy growth in AUMs (46% yoy) and higher margins (+20 bps qoq to 10.5%). Micro loan AUMs grew by 44% yoy and non-micro loans AUMs by 64% yoy. The bank had exposure to IL&FS amounting to ₹ 3.9 bn, for which it provided 100% during the quarter. This distorted the NPLs resulting in GNPL rising to 2.4% from 1.3% qoq. Barring this account, asset quality performance was stable for the quarter. Despite RBI's restriction on future branch opening of the bank, leverage on the existing network continued – it added 9.2 lakh customers vs. 7.6 lakh in Q2, CASA inched upto 41.4% vs. 36.9% qoq, deposits grew by 37% yoy. Going forward, mgmt said it is not looking for another acquisition in the near term to dilute the promoter stake further.

Merger is book value dilutive - Bandhan Bank has paid considerable high price for the merger with Gruh Finance, valuing the company at Rs207 bn (i.e. @282 per share or 12.5x P/BV multiple (Q2FY19 BV). Resultant, dilution is steep at 25% (on combined entity). With merger, AUMs would increase by 33%, total assets by 41%, no. of branches by 17% and PAT (H1FY19) by 18.5%. ROA (H1FY19 annualised) of the combined entity would decline by 50 bps to 3.7% as compared to Bandhan numbers while ROE would increase by 100 bps to 20%. Respective boards of both companies approved the scheme of amalgamation of Gruh Finance into Bandhan Bank in all share swap deal. Share exchange ratio for merger is – shareholders of Gruh Finance would get 56.8 shares of Bandhan Bank for every 100 shares of Gruh Finance. Merger would reduce the promoter stake in the company from current 82% to 61%. HDFC would own 14.96% in the combined entity post-merger. The scheme of amalgamation is effective 1st January 2019.

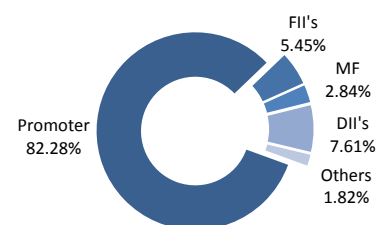
Synergies – Merger would give both entities desired diversification of product mix and geographical distribution. Interestingly, both the companies cater to bottom of the pyramid segment. Gruh would get benefit of low cost deposits of Bandhan, while also on the other hand, there would be burden of maintaining SLR & CRR. Although the merger is apt strategic fit and would yield fruitful results in the longer run, higher price paid for the acquisition would be near term negative.

Shareholding - Merger would reduce the promoter stake in the company from current 82% to 61%. Also, HDFC would own 14.96% in the combined entity, for which RBI approval would be required. As NBFC can hold maximum 5% stake in the bank under automatic route, for any further higher stake in the bank, RBI approval is required. Merger was fallout of RBI mandate to reduce the promoter stake in the company from 80% to 40%. The bank would require another acquisition to reduce down the stake further beyond 61% - this again will remain overhang on the stock in the near term.

Valuations – Although the merger would result in long term synergies in terms of geographic distribution, product diversification, but in near term, it is book value dilutive. Another overhang will be to bring down the promoter stake further down from 61% levels capping any future upside on the stock. This will be one big negative for the bank over-riding its expected strong core future performance. For the same reason, we are keeping our current rating (TP of ₹ 760) on the stock "Under Review" till we revisit numbers on combined entity.

Stock Data

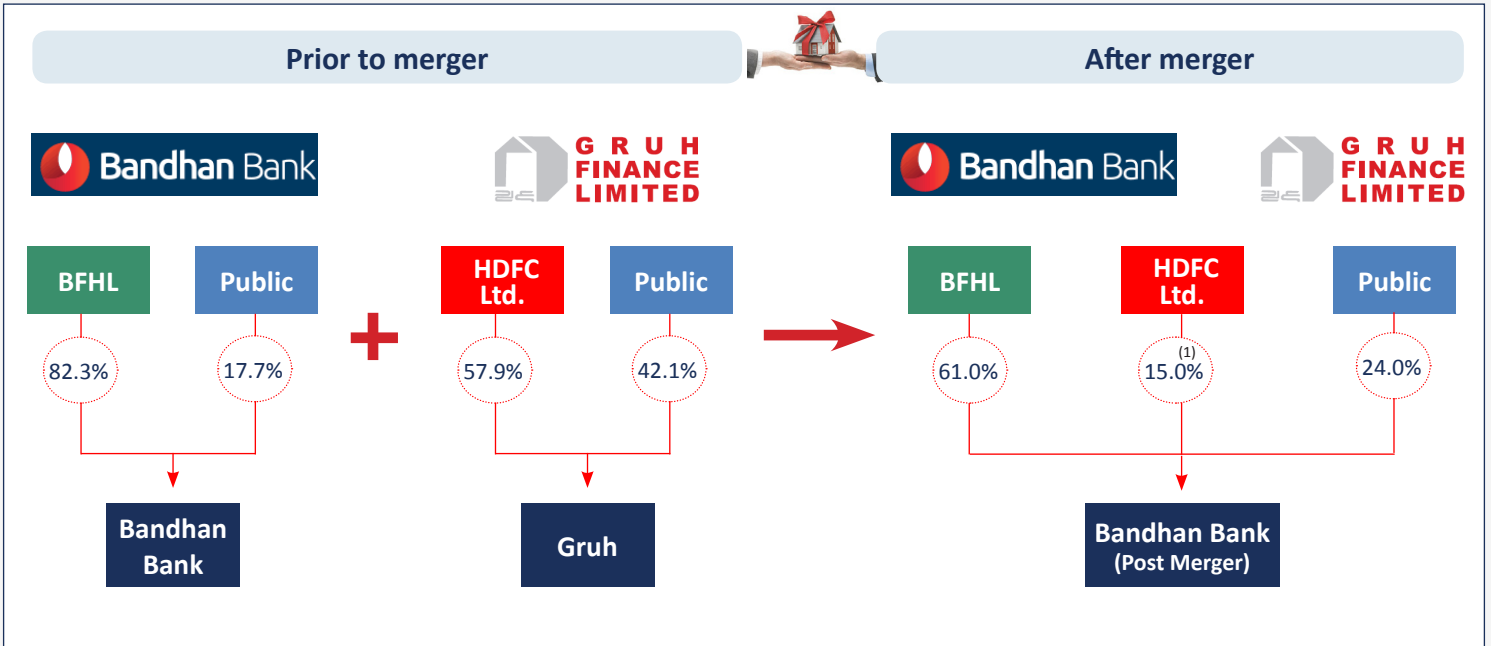
Rating	Under Review
Current Market Price(₹)	460
12 M Price Target (₹)	Under Review
Potential upside (%)	-
FV (₹)	10
Market Cap Full (₹ bn)	545
52-Week Range (₹)	742 / 368
BSE / NSE Code	541153 / BANDHANBNK
Reuters / Bloomberg	BANH.NS /BANDHAN:IN

Shareholding Pattern (September 2019)

YE Mar	FY18	FY19E	FY20E	FY21E
PAT (₹ mn)	13,456	19,416	26,179	35,879
yoy (%)	21.0	44.3	34.8	37.1
BV (₹)	78.7	99.8	131.1	173.9
ABV (₹)	77.2	96.8	126.6	167.4
P/ABV (x)	8.1	4.8	3.6	2.7
ROE (%)	19.5	18.2	19.0	19.7
ROA (%)	3.6	3.7	3.7	3.7
Gross NPAs (%)	1.3	1.9	2.2	2.3
PCR (%)	53.7	54.4	56.5	57.7

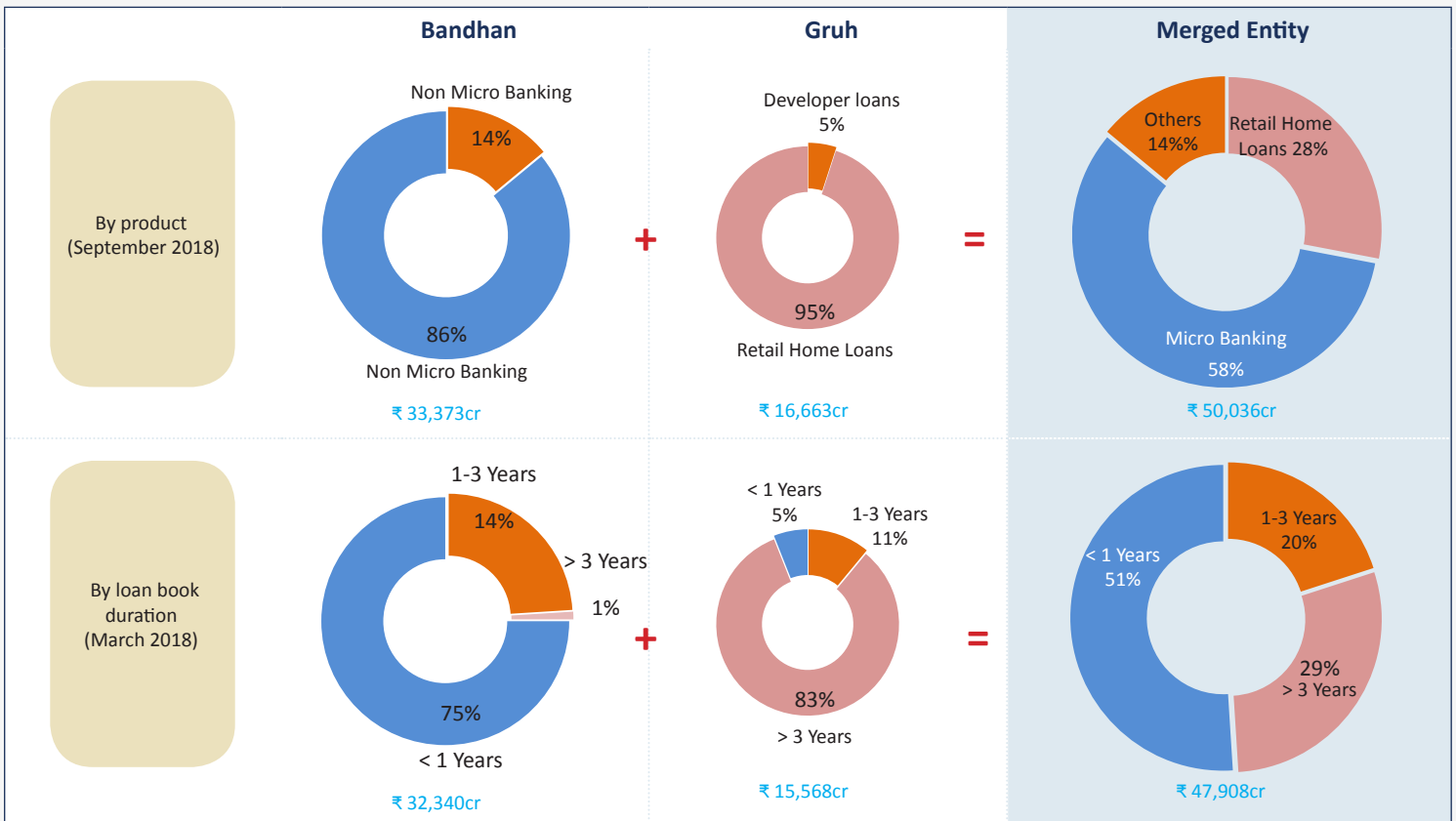
Relative Price Performance

Shareholding pattern of both companies prior and post merger



Source: Company, LKP Research

Details of Loan Book of both companies prior and post merger



Source: Company, LKP Research

Merger Details

(₹.mn)	Bandhan Bank	Gruh Finance	Combined Entity	Change (%)
Total Assets	4,56,044	1,85,030	6,41,074	40.6
Networth	1,02,075	16,617	1,18,692	16.3
Equity Capital	11,928	1,465	16,088	34.9
FV of shares (₹)	10	2		
No. of shares	1,193	732	1,609	
BV (₹)	85.6	22.7	73.8	-13.8
EPS (H1FY19 Annualised)	8.1	3	7.4	-9
PAT (Q2FY19)	4,880	1,050	5,930	17.7
PAT (H1FY19)	9,690	2,200	11,890	18.5
AUM	3,33,730	1,66,630	5,00,360	33.3
Deposits	3,29,589	9,000	3,38,589	2.7
Borrowings	14,218	1,64,895	1,79,113	92.1
ROA (%) (H1 Annualised)	4.2	2.4	3.7	-50 bps
ROE (%) (H1 Annualised)	19	26.5	20	+100 bps
No. of branches	938	194	1,132	17.1

Source: Company, LKP Research

About Bandhan Bank

Incorporated in West Bengal in 2001, Bandhan Bank, the largest micro-finance lender in the East & North-eastern India, is the only NBFC MFI to receive universal banking license from RBI in 2015. With the balance sheet size of ₹ 456 bn, micro-finance loans occupy the dominant share of 86% of its loan book. Currently, it has 3010 DSCs (Doorstep Service Centres), 938 bank branches, 476 ATMs together serving 11.5 mn micro loan customers & 2.94 mn general banking customers (14.41 total customers). It has dominant presence in North & North-Eastern States (West Bengal, Assam, Bihar) together accounting for 67% of its branches.

Within short term of 3 years of receiving banking license, the bank has successfully transitioned itself from the micro-finance lender to universal bank visible from the fact that it has garnered sizeable share of retail liabilities & CASA forming 82% and 37% (Q2FY19) respectively of the total deposits. Post incorporated as bank, it has also started general banking business offering various liabilities & asset products (home loans, PL, gold loans etc.)

Micro-loan business began in 2001 as an NGO named Bandhan Konnagar providing microfinance services to socially & economically disadvantaged women in West Bengal. Later, Bandhan Financial Services (BFSL) was formed in 2006 and NGO transferred its micro finance business to BFSL in 2009 and ultimately, BFSL transferred the business to Bandhan Bank.

Currently Bandhan Financial Services Ltd is ultimate parent company and which has wholly owned subsidiary called Bandhan Financial Holdings Ltd, which in turn has 82.3% stake in Bandhan Bank

About Gruh Finance

Subsidiary of HDFC, Gruh Finance is one of the most profitable HFC having top quartile return ratios. It was promoted by HDFC and AKFED in 1986. Currently, HDFC owns 57.9% stake in the NBFC. It has total outstanding AUMs of 166.6 bn, of this 95% of the loans are retail ones (and 46% of the loans are at locations where the population is less than 50000). It has 196 branches spread across 133 districts in 11 states (Q2FY19). As at Sep'18, ROE and ROA of the NBFC is 27.3% and 2.6% respectively.

Q3FY19 Result Highlights

(₹.mn)	Q3FY19	Q3FY18	yoy (%)	Q2FY19	qoq (%)	9MFY19	9MFY18	yoy (%)
Interest earned	16,496	11,782	40	16056	2.7	48114	34517	39.4
-Interest/discount on advances/bills	14,356	9,549	50.3	13998	2.6	41334	26451	56.3
-Income on investments	1,513	1,298	16.6	1594	-5.1	4616	3536	30.6
-Interest on bal. with RBI	126	211	-40.2	125	0.5	598	1320	-54.7
-Others	501	725	-30.8	338	48.3	1566	3210	-51.2
Interest expenses	5,256	4,464	17.7	5282	-0.5	15727	12829	22.6
Net Interest Income (NII)	11,240	7,318	53.6	10775	4.3	32386	21688	49.3
Other Income	2,341	1,582	48	2304	1.6	6752	5028	34.3
Total income	13,581	8,900	52.6	13079	3.8	39138	26716	46.5
Operating expenses	4,576	3,155	45	4339	5.5	13189	9453	39.5
-Employee cost	2,558	1,630	56.9	2342	9.2	7388	4994	47.9
-Other operating expenses	2,019	1,526	32.3	1997	1.1	5801	4460	30.1
Operating profit	9,005	5,745	56.7	8740	3	25950	17263	50.3
Provision for contingencies	3,776	1,225	208.2	1242	204.1	5819	2651	119.5
PBT	5,228	4,519	15.7	7498	-30.3	20131	14612	37.8
Provision for taxes	1,916	1,519	26.1	2622	-26.9	7125	5035	41.5
Net profit	3,313	3,000	10.4	4877	-32.1	13006	9577	35.8
Equity	11,928	10,951	8.9	11928	0	11928	10951	8.9
EPS (₹)	2.8	2.7	1.4	4.1	-32.1	10.9	8.7	24.7
Ratios (%)								
Int. exp/Int earned (%)	31.9	37.9	-	32.9	-	32.7	37.2	-
Cost/Income ratio (%)	33.7	35.5	-	33.2	-	33.7	35.4	-
Gross NPAs (₹)	8,310	3,863	115.1	4133	101	8310	3863	115.1
Net NPAs (₹)	2,367	1,841	28.6	2204	7.4	2367	1841	28.6
Gross NPAs (%)	2.41	1.67	-	1.29	-	2.4	1.7	-
Net NPAs (%)	0.7	0.8	-	0.7	-	0.7	0.8	-
ROA (%)	0.7	0.9	-	1.1	-	1.5	1.5	-
CAR (%)	32.8	24.9	-	32.6	-	32.8	24.9	-
Provision coverage (%)	71.5	52.3		46.7		71.5	52.3	
Yield on advances (%)								
Balance Sheet (₹.mn)								
Deposits	3,46,393	2,52,940	36.9	3,29,589	5.1	3,46,393	2,52,940	36.9
Investments	86,181	72,912	18.2	85,787	0.5	86,181	72,912	18.2
Advances	3,38,729	2,29,307	47.7	3,17,298	6.8	3,38,729	2,29,307	47.7

Source: Company, LKP Research

Profit & Loss Statement

(₹.mn)	FY17	FY18	FY19e	FY20e	FY21e
INTEREST EARNED	39,087	48,023	68,110	92,777	1,25,039
Interest/Discount on advances/Bills	31,214	38,236	57,204	78,394	1,06,113
Income from Investment	4,281	4,900	7,712	11,013	15,072
Interest on Balances with RBI & Others	790	1,416	1,500	1,600	1,700
Others	2,802	3,471	1,694	1,769	2,154
INTEREST EXPENDED	15,052	17,701	25,375	35,603	49,606
Interest on Deposits	12,911	16,816	24,638	34,575	48,347
Interest on RBI/Inter-Bank Borrowings	1,588	516	400	500	500
Others	553	369	336	528	759
Net Interest Income (NII)	24,035	30,322	42,736	57,174	75,433
OTHER INCOME	4,114	7,062	9,189	12,143	15,992
TOTAL INCOME	28,149	37,384	51,925	69,316	91,425
OPERATING EXPENSES	10,220	13,083	16,675	21,388	27,211
OPERATING PROFIT	17,929	24,301	35,250	47,928	64,215
PROVISIONS	884	3,742	5,563	7,899	9,354
Provision for Non-Performing Assets	478	2,261	3,566	5,266	7,238
Profit Before Tax (PBT)	17,045	20,559	29,687	40,030	54,861
PROVISIONS FOR TAXES	5,925	7,103	10,272	13,850	18,982
PAT	11,120	13,456	19,416	26,180	35,879
(% change)	304	21	44.3	34.8	37.1
EPS (₹)	10.2	11.3	16.3	21.9	30.1
Total Paid-Up Capital	10,951	11,928	11,928	11,928	11,928

Source: Company, LKP Research

Balance Sheet

(₹.mn)	FY17	FY18	FY19e	FY20e	FY21e
APPLICATION OF FUNDS					
Cash & bank balances	60,121	28,371	23,119	25,480	32,997
Bal. with banks and money at call & short notice	13,529	26,735	22,082	36,898	48,185
Advances	1,68,391	2,97,130	4,17,925	5,74,408	7,86,021
Investments	55,165	83,719	1,27,565	1,66,125	2,25,355
Fixed Assets	2,518	2,381	2,834	3,429	4,149
Other Assets	2,637	4,764	7,193	10,070	14,099
TOTAL ASSETS	3,02,361	4,43,101	6,00,718	8,16,410	11,10,806
SOURCES OF FUNDS					
Total Paid-Up Capital	10,951	11,928	11,928	11,928	11,928
RESERVES & SURPLUS	33,513	81,891	1,07,089	1,44,453	1,95,517
DEPOSITS	2,32,287	3,38,690	4,67,392	6,40,327	8,77,248
BORROWINGS	10,289	2,850	4,625	7,113	9,746
OTHER LIABILITIES & PROVISIONS	15,320	7,741	9,684	12,589	16,366
TOTAL LIABILITIES	3,02,361	4,43,101	6,00,718	8,16,410	11,10,806

Source: Company, LKP Research

Ratios

A) Efficiency Ratios (%)	FY17	FY18	FY19e	FY20e	FY21e
Int. exp/Int. earned	38.5	36.9	44.4	45.4	46.7
NII / Total Income	85.4	81.1	82.3	82.5	82.5
Other income / Total Income	14.6	18.9	17.7	17.5	17.5
Fee income / Other income	77.9	57.3	61.4	63.9	66.4
Fee income / Total Income	11.4	10.8	10.9	11.2	11.6
Cost / Income	36.3	35.0	32.1	30.9	29.8
C-D ratio	72.5	87.7	89.4	89.7	89.6
I-D ratio	23.7	24.7	27.3	25.9	25.7
Loan / Assets ratio	55.7	67.1	69.6	70.4	70.8
Deposits / Assets ratio	76.8	76.4	77.8	78.4	79.0
CASA / Total Deposits	29.4	34.3	35.0	35.0	35.0
B) Spreads (%)	FY17	FY18	FY19e	FY20e	FY21e
Yield on Assets	15.9	13.1	11.1	11.2	11.2
Yield on Advances	21.3	16.4	16.0	15.8	15.6
Yield on Investments	9.2	7.1	7.3	7.5	7.7
Cost of Funds	7.6	6.1	6.2	6.4	6.5
Cost of Deposits	7.3	5.9	6.1	6.2	6.4
Cost of Earning Assets	6.1	4.8	4.9	5.1	5.2
Net Interest Spread	8.3	7.0	4.9	4.9	4.7
Net Interest Margin	9.8	8.3	8.3	8.2	8.0
C) Solvency Ratios (%)	FY17	FY18	FY19e	FY20e	FY21e
Gross NPAs (₹)	862.6	3731.4	7739.2	12386.7	18337.0
Net NPAs (₹)	611.7	1729.0	3525.7	5384.7	7764.8
Provisions (₹ mn)	250.8	2002.3	4213.5	7002.0	10572.2
Gross NPAs / Gross Advances (%)	0.5	1.3	1.9	2.2	2.3
Net NPAs / Net Advances (%)	0.4	0.6	0.8	0.9	1.0
Credit Cost (%)	0.3	0.8	0.9	0.9	0.9
Credit Cost (%)	0.5	1.1	1.1	1.1	1.1
Provisions Coverage Ratio (%) (Excl. FI. Prov.)	29.1	53.7	54.4	56.5	57.7
D) Measures of Investment	FY17	FY18	FY19e	FY20e	FY21e
EPS (₹)	10.2	11.3	16.3	21.9	30.1
BV (₹)	40.6	78.7	99.8	131.1	173.9
Adjusted BV (₹)	40.0	77.2	96.8	126.6	167.4
DPS (₹)	0.0	0.0	1.0	1.0	1.0
Avg. ROE (%)	28.6	19.5	18.2	19.0	19.7
Avg. ROA (%)	4.4	3.6	3.7	3.7	3.7
P/E (x)	61.5	55.3	28.3	21.0	15.3
P/BV (x)	15.4	7.9	4.6	3.5	2.6
P/ABV (x)	15.58	8.1	4.8	3.6	2.7
Dividend Payout ratio (%)	0.0	0.0	6.1	4.6	3.3
Effective tax rate (%)	34.8	34.6	34.6	34.6	34.6

Ratios

E) Breakdown of ROA (%)	FY17	FY18	FY19e	FY20e	FY21e
Interest Income	15.6	12.9	11.0	11.1	11.0
Interest expenses	6.0	4.7	4.9	5.0	5.1
NII/avg assets	9.6	8.1	8.2	8.1	7.8
Non-NII/avg. assets	1.6	1.9	1.8	1.7	1.7
Total Income	11.3	10.0	9.9	9.8	9.5
Operating exp/avg. assets	4.1	3.5	3.2	3.0	2.8
Operating profit/avg. assets	7.2	6.5	6.8	6.8	6.7
Provisions/avg. assets	0.4	1.0	1.1	1.1	1.0
PBT/avg. assets	6.8	5.5	5.7	5.6	5.7
Tax/avg. assets	2.4	1.9	2.0	2.0	2.0
PAT/avg. assets	4.4	3.6	3.7	3.7	3.7
Leverage	6.8	4.7	5.0	5.2	5.4
F) Growth Rates (%)	FY17	FY18	FY19e	FY20e	FY21e
Interest Income	147.2	22.9	41.8	36.2	34.8
Interest Expenses	132.1	17.6	43.4	40.3	39.3
NII	157.7	26.2	40.9	33.8	31.9
Other Income	174.5	71.6	30.1	32.1	31.7
Total Income	160.0	32.8	38.9	33.5	31.9
Operating Income	284.1	35.5	45.1	36.0	34.0
Net Profit	304.0	21.0	44.3	34.8	37.1
Deposits	92.2	45.8	38.0	37.0	37.0
Advances	35.4	76.5	40.7	37.4	36.8

Source: Company, LKP Research

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