Bandhan Bank – "Buy"

CMP 490-500

TP 650

Upside 32%

18th December 2019

Bandhan Bank has reported an awesome set of numbers in 1QFY20. It has reported strong numbers on all fronts asset quality, Advances growth, profitability and margin. PAT jumped substantially by 45% YoY to Rs 701 cr, supported by strong topline growth and lower provisioning coupled with higher operating profit aided PAT growth. Robust growth in advances at 39% YoY and healthy NIM led to NII growth CASA marginally down but still continues to remain healthy. Income from PSLC was at Rs 92.5 crore in Q1FY20.Advances is growing at 39.4% YoY (Micro banking +40%) along with higher non-interest income and operating leverage on costs, drove an operating profit growth of 47% Y/Y.Robust growth in other income and higher margin with normal credit costs enabled Bandhan to deliver 4.89% ROA during the quarter. Lower slippages led to steady asset quality with GNPA ratio at 2.02% (1.1% ex IL&FS). CASA ratio increased to 36.1% from 35.5% YoY, retail deposits to total deposits stood at 76.1%. Margins improved further from 10.3% to 10.5% YoY led by improvement in yields. Asset quality of the bank was stable with a GNPA at 2% flat QoQ.

Robust growth to sustained in Advances and Deposits

Bandhan Bank has shown stellar advances growth at 50% CAGR in FY19 to FY21E despite the AP crisis, fani cyclone and demonetization. As of Q1FY20, Advances was at Rs 45420 crore, with customer base at 1.72 crore. In Q1FY20 Bandhan Bank has opened 7.25 lakh new account and 5 lakh opened by Micro credit and 2.25 lakhs opened by my bank branch. Total number of active borrowers increase by 23.8% yoy to 9.84 mn. Non-micro loan, forming 14% of the advances, grew by 35.5% yoy. Within non-micro loans, retail and MSME loans declined on qoq basis while NBFC-MFI loans jumped up 13.9% qoq. The micro finance book growth momentum continued to remain robust led by new customer addition as well as increase in average ticket size. With the bank expanding in new geographies and subsequent increase in customer addition, Customers who used to borrow solely from Bandhan are now at 55% vs. 60% in the last quarter. Operating profit growth was strong at 47% yoy. Margins were marginally down by 20 bps qoq to 10.5% due to surge in cost of deposits. Income from the PSLC was at ₹3.7 bn, of this, it recognized ₹0.93 bn in Q1 while the rest would be spread over the next 3 quarters expect deposits growth at 33% CAGR in FY19-21E to 76106 crore. CASA saw de-growth while term deposit continued to gain traction. Accordingly, CASA moderated to 36.1%, down 465 bps QoQ Stable asset quality

Asset quality stays robust backed by solid OTR (on time repayment)

Slippages during the quarter were at Rs 137 Cr vs 100 Cr qoq. Gross/net NPAs were largely retained at 2%/0.56% on qoq basis. Lower slippages led to steady asset quality with GNPA ratio at 2.02% (1.1% ex IL&FS). Absolute GNPA was at Rs 851 crore vs. Rs 820 crore in Q4FY19. The management has given guidance that In may they have noticed that to their OTR has come down 88% from 99.3% but now thing are under control after one and half months when this fani cyclone has been over. Now total recovered from June. Overall portfolio quality remains healthy with PAR30 being at 0.9% and collection efficiency at 99%.

CASA ratio falls in line with the industry trend

Within one quarter itself, CASA ratio of the bank has fallen from 41% to 36% led by both decline in CA and SA deposits. Bandhan remained strong with CASA + Retail TDs growing 35% YoY CASA ratio at 36.1%, however, fell off due to given high asset growth and shift of savings accounts toward term deposits. This then resulted in cost of funds rising 50bps QoQ and spreads coming off 50bps QoQ (though still up 20bps YoY). CASA + Retail Term deposits accounted for 76% of the company's funding vs. 77.4% in 4Q19.

Unique business model imparting highest margins in industry

Bank draws one of the highest margins in the industry at 10.45% in Q1FY20 which is led by high yielding micro loans coupled with lower funding costs. This is one of the reason it enjoys healthy return profile. We expect margins would be sustained at current levels of above 10% over FY19-21E given more downside to lending rates is limited and CASA & retail deposits growth would be healthy.

Bandhan Bank will get higher benefit from Tax Rate Cut From 35% to 25.17%

Bandhan Bank's Net profit should go up by 13 to 14% because of this the rate cut, 13% to 14% higher profit that Bandhan bank get. It get added their net worth and tier one ratio .Higher tier one ration allow them lend more to clients even if they are keeping their leverage as it is. Expect in future their loan book opportunity goes up, as their ROE goes up because of profit is growing. Currently Tier one ration is at 25.75% they won't add this quarter's profit due to ILFS exposure Gross NPA has grown by 25% Vs FY18 hence this year FY19 till the accounts are audited. They are not including profit for the purpose of capital adequacy. once the account get audited at the year end, these profit will be considered.

Valuation

Robust growth in Advances, unique business model sustain high NIM margin in industry and control on asset quality continue to remain strong attributes of the bank. With respect to merger with Gruh Finance, the bank is awaiting approval from NCLT. Post-merger basis, RoE of Bandhan Bank is expected to be 17.1%, RoA at 4% on FY21E basis. Robust pace of customer acquisition and increase in ticket size bodes well for future growth of micro loans. We believe the merger is short-term negative due to high dilution but remains positive in the long run. However, given recent headwinds in home finance sector, Expect PAT to grow at CAGR of 34% during FY19-21E backed by superior return ratios (ROE 17.1% and ROA 4% IN FY20E) and strong visibility of credit growth. Bandhan Bank trades at 5.2X FY20E P/ABV and 4.4X FY21E. We rate the stock a BUY with a target price of INR 590, assigning a FY21E P/ABV of 5.2X

Con-call Highlights: Q1FY20

- Management has given guidance on Branch opening: Bank is likely to open 187 branches and 340 DSCs during the year. Bank has received board approval and likely to apply with the RBI soon.
- In terms of customer's profile, 55% of its customers are banking with Bandhan for more than more than 3 loan cycle and rest are in 1-3 cycle.
- Gross Slippages during the quarter were Rs 137 cr.
- At present Bandhan has 999 branches, 481 ATMs, 3014 DSCs and 32,774 employees.
- CASA is guided to be stay in the range of 35-40%.
- Cost of SA deposits stayed stable at 5.13% vs. 5.12% last quarter with average SA balances at Rs 35000.
- CASA ratio dropped to 36% vs.41% last quarter and was largely driven by shift to retail term deposits as customers wanted to lock-in higher rates. Also, there was reduction in government deposits during the election period. CASA + Retail TD for the quarter stood at 76.5% vs. 77.4% last quarter. YoY CASA growth largely came from non-eastern region with western region growing at 74% y/y and Central at 52% and similar trend holds for retail TD. Micro credit customers accounted for 6% of the overall deposit base.

Merger with Gruh Finance Ltd to reduce the Promoter group stake

As per the RBI guidelines, Bandhan Bank was supposed to bring down its Promoter shareholding to 40% from existing 82% by August, 2018. Bandhan Bank did not reduce its stake resulted in freeze of remuneration of CEO & MD and restriction to open new branches without RBI prior permission. As per latest development, we find that Bandhan bank has made an agreement with Gruh Finance Ltd. to acquire its entire business. Gruh Finance Ltd. offers home loans at lower interest rate. It is the subsidiary of HDFC ltd. where holding of HDFC Ltd. is 57.86%. The proposed merger is likely to bring down Bandhan bank promoter group shareholding from present 82% to 61% and HDFC Ltd. Bandhan's announced merger will reduce the promoter shareholding to 61% vs. 82.3% pre-merger. Bandhan still needs an additional plan to reduce shareholding to 40% vs. the current 60% to comply with RBI's norm. Additional M&A for further reductions in the promoter shareholding remains a risk to the stock price, in our view.

HDFC will likely need to sell down a stake in Bandhan Bank.

Following the merger, HDFC Ltd.'s stake in Bandhan Bank will stand at 15%, and HDFC will likely need to sell down a 5% stake to comply with the less than 10% shareholding norm (RBI permits a non-bank to hold not more than 9.9% in a bank and requires RBI approval for holdings in excess of 5% in a bank permitted via the automatic route).

Gruh Finance merger

should be accretive as the business in our view brings complementary skills to Bandhan in rural housing finance, a key identified area of growth for the company. While synergy benefits on this account will likely take time to play out, Gruh's strong competitive positioning in rural housing lending adds to Bandhan's leadership in micro finance. The company expects the merger to conclude within fiscal 2020.

Merger Swap Ratio

Bandhan Bank is currently trading at Rs 499 per share, while Gruh Finance trading at Rs 266 per share. The swap ratio set for the merger at 568 shares of Bandhan Bank for every 1,000 shares of Gruh Finance, and the prevailing stock prices of the two scrips suggest shares of Bandhan Bank are trading at an 6% premium to the swap ratio.In Simple words, the shareholders of Gruh Finance (HDFC and outside shareholders) will receive higher valued shares compared to their current valued holdings.