

Bandhan Bank IPO Note : Expensive Valuations – Subscribe Only With Long Term View



Strong Business Potential – However Steep Valuations rule out the possibility of immediate listing gains

While the bank has strong asset quality, high profitability as well as growth rates, it is demanding 4-5 times valuation which is at par with the most strong private sector banks that have an impressive track record of over three decades

Bandhan Bank is the latest entrant in the banking sector which successfully bagged banking licence from the Reserve Bank of India in April 2014. The bank was incorporated on 23 December 2014 and began operations on 23 August 2015, when Bandhan Financial Services (BFSL) transferred its entire microfinance business to the bank and simultaneously commenced general banking activities. In 2001 a non-governmental organisation (NGO), Bandhan Konnagar, started providing microfinance services to socially and economically disadvantaged women in rural West Bengal. BFSL started its microfinance business in 2006 and the NGO transferred its microfinance business to BFSL in 2009 and thereby the entire microfinance business was undertaken by BFSL. It applied for the banking license in 2013. BFSL transferred its microfinance business to the bank, when it had emerged as India's largest microfinance company by number of customers and size of loan portfolio.

Bandhan Bank is a commercial bank focused on serving underbanked and underpenetrated markets in India. The bank currently offers a variety of asset and liability products and services designed for micro banking and general banking, as well as other banking products and services to generate non-interest income. Its strength lies in microfinance, including a network of 2,022 doorstep service centres (DSCs) and 6.77 million micro loan customers transferred from BFSL, which have grown to 2,633 DSCs and 9.86 million micro loan customers end December 2017.

Since obtaining banking license, the bank has also focused particularly on creating a strong

general banking business to complement micro loan business. The bank has launched general banking business on 23 August 2015 by opening a greenfield network of 501 bank branches and 50 automated teller machines (ATMs), which have grown to 887 bank branches and 430 ATMs, together serving over 2.13 million general banking customers end December 2017. The distribution network is particularly strong in east and northeast India, with West Bengal, Assam and Bihar together accounting for 56.4% of branches and 57.6% of DSCs end December 2017, though focus is to expand across India.

The bank currently offers a variety of asset and liability products and services designed for micro banking and general banking. 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. About 96.5% of gross advances of the bank were priority sector lending (PSL) norm compliant, which is way above the requirement of 40%. Liability products consist of savings accounts, current accounts and a variety of fixed deposit accounts. Since beginning banking operations, the bank has built a strong base of current account and savings account deposits, which together account for 33.22% of total deposits. Further, the retail-to-total deposit ratio stood at 85.07%. The bank believes that its CASA ratio provides a stable source of low-cost funding, allowing to provide cost-effective loans to target customer base.

In addition to loan and deposit products, the bank is also offering other banking products and services to generate non-interest income and cater towards the additional needs of customers. 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. In addition, because its PSL portfolio significantly exceeds the RBI's PSL requirements, the bank is able to generate PSL certificates that are sold to other banks, providing with an additional stream of non-interest income.

The Offer and the Objects

The bank is coming out with an IPO to collect around Rs 4413 crore at the lower price band of Rs 370 per share (face value Rs 10 per share) and Rs 4473 crore at the upper band of Rs 375 per share, consisting of a fresh issue of equity shares (Rs 3614 crore to Rs 3662 crore) aggregating to 9.77-crore equity shares and offer for sale of equity shares (Rs 800 crore to Rs 811 crore) aggregating to 2.16-crore equity shares.

The offer for sale includes sale of equity share of up to 14,050,780 equity shares by IFC and up to 7,565,804 equity shares by IFC FIG. The issue is to be made through a book building process and will open on 15 March 2018 and will close on 19 March 2018.

In terms of the RBI New Bank Licensing Guidelines, the equity shares of the bank are required to get listed on the stock exchanges within three years from the date of commencement of business, i.e., on or before 22 August 2018. The bank is undertaking this Issue in line with the RBI regulatory requirement to get listed on the stock exchanges on or before 22 August 2018.

The objective of the fresh issue is also to augment bank's Tier-I capital base to meet the bank's

future capital requirements. The bank also believes that the listing of equity shares will enhance the bank's visibility and brand name among existing and potential customers.

Strengths

The net interest margins (NIMs) of the bank was strong at 9.86%, return on equity (RoE) of 25.55% and return on assets (RoA) of 4.07% (each on an annualized basis) in the nine months ended December 2017 compared with 10.34%, 27.88% and 4.39% in the nine months ended December 2016. The bank has maintained good asset quality amidst challenging macro environment. The gross NPAs stood at 1.67% and the net NPAs at 0.80% at end December 2017.

The bank has grown quality asset base over the various phase of development. Its gross loan book has grown from and Rs 7768.79 crore as on 23 August 2015 to Rs 15578.44 crore end March 2016 to Rs 24364.39 crore end December 2017, while customers have increased from 6.77 million to 11.99 million. Deposits base have jumped to Rs 25293.96 crore with CASA ratio of 33.2% and retail deposits ratio of 85.1% end December 2017. The growth in low-cost liability business has led to a reduction in cost of funding, allowing the bank to lower the lending interest rates while maintaining profitable spreads and further grow portfolio and capture market share.

The bank's distribution network is relatively low cost, which in particular is a result of "hub and spoke" model of using DSCs and associated bank branches, as well as focus on tech initiatives. This low-cost model is demonstrated by operating cost-to- income ratio was 35.38% for the nine months ended December 2017 and 36.31% for FY2017.

Weaknesses

Limited operating history and fast growing and rapidly evolving business make it difficult to evaluate business and future operating results on the basis of past performance, and future results may not meet or exceed past performance. Moreover its 96 per cent loan book is unsecured. A substantial portion of operations are located in East and Northeast India, making it vulnerable to risks associated with having geographically concentrated operations.

Microcredit lending has its own unique risks and, as a result, the bank may experience increased levels of nonperforming loans and related provisions and write-offs that negatively impact results of operations.

The micro finance loan portfolio of the bank is not supported by any collateral that could help ensure repayment of the loan, and in the event of non-payment by a borrower of one of these loans, the bank may be unable to collect the unpaid balance.

The RBI New Bank Licensing Guidelines requires, among other things, promoter, BFHL to reduce its shareholding in Bank to 40% within three years from the date of commencement of business as a bank. BFHL is also required to reduce its shareholding further to 20% and 15% within 10

years and 12 years, respectively, from the date of commencement of business as a bank.

Valuation

Bandhan Bank's EPS for 9M of FY2018 on post-issue equity works out to Rs 10.7. At the price band of Rs 370 to Rs 375, P/E works out to 34.6 to 35.0 times.

Post-issue book value of Bandhan Bank works out to Rs 75.6 at the issue price of 370 and Rs 76.0 at the issue price of Rs 375. P/BV works out to 4.9X and P/Adj BV is at 5.0X at the upper price band.

Among the comparable banks, RBL Bank is trading at P/BV (on 9M FY2018 BV) of 3.0X, AU Small Finance Bank is trading at P/BV of 8.4X, Yes Bank is trading at P/BV of 2.8X, Indusind Bank is trading at P/BV of 4.4X. Among the comparable NBFCs and leading microfinance lenders, Equitas Holding is trading at P/BV of 2.8X, Ujjivan Financial Services is trading at P/BV of 2.4X and Bharat Financial Inclusion is trading at P/BV of 5.6X.

| Bandhan Bank : Issue highlights | |
|---|---------------|
| For Fresh Issue Offer size (in Rs crore) | |
| - On lower price band | 3613.56 |
| - On upper price band | 3662.40 |
| Total Issue size for fresh issue (in no. of shares) | 9.77 crore |
| For Offer for Sale Offer size (in Rs crore) | |
| - On lower price band | 799.81 |
| - On upper price band | 810.62 |
| Total Issue size for Offer for Sale issue (in no. of shares) | 2.16 crore |
| Price band (Rs) | 370-375 |
| Minimum Bid Lot (in no. of shares) | 40 |
| Post issue capital (Rs crore) | 1192.80 |
| Post-issue promoter & Group shareholding (%) | 82.30 |
| Issue open date | 15-3-2018 |
| Issue closed date | 19-3-2018 |
| Listing | BSE,NSE |
| Rating | 46/100 |

Bandhan Bank: Comparison of Accounting Ratios with Listed Industry Peers as of March 31, 2017

| Name | Type | Face Value per equity share (Rs) | Total income (in Rs crore) | Basic EPS (Rs) | P/E | P/B | RoNW (%) | Net Asset Value (Rs) |
|--|----------------|----------------------------------|----------------------------|----------------|-------|------|----------|----------------------|
| Bandhan Bank | Bank | 10 | 4320 | 10.15 | - | - | 25.01% | 40.60 |
| Peers | | | | | | | | |
| Axis Bank | Bank | 2 | 57597 | 16.54 | 35.88 | 2.52 | 7.04% | 235.41 |
| HDFC Bank | Bank | 2 | 86149 | 59.95 | 33.47 | 5.6 | 16.65% | 358.21 |
| IndusInd Bank | Bank | 10 | 18577 | 48.06 | 36.5 | 5.09 | 13.90% | 344.91 |
| ICICI Bank | Bank | 2 | 113398 | 17.51 | 20.16 | 1.96 | 10.84% | 179.63 |
| IDFC Bank | Bank | 10 | 9597 | 3 | 18.75 | 1.3 | 7.24% | 43.18 |
| Kotak Mahindra Bank | Bank | 5 | 33984 | 26.89 | 41.27 | 5.31 | 12.86% | 209.09 |
| RBL Bank | Bank | 10 | 4469 | 12.61 | 40.03 | 4.37 | 10.29% | 115.57 |
| YES Bank | Bank | 10 | 20643 | 79.12 | 4.48 | 0.73 | 15.15% | 482.81 |
| AU Small Finance Bank | SFB | 10 | 1446 | 11.73 | 56 | 9.39 | 38.33% | 69.92 |
| Equitas Holdings | SFB (Hold Co.) | 10 | 1557 | 4.79 | 30.97 | 2.25 | 7.14% | 66.03 |
| Ujjivan Financial Services | SFB (Hold Co.) | 10 | 1398 | 17.76 | 21.29 | 2.57 | 11.83% | 147.03 |
| Bajaj Finance | NBFC | 2 | 10007 | 34.01 | 49.32 | 9.61 | 19.13% | 174.59 |
| Gruh Finance | NBFC | 2 | 1487 | 8.15 | 71.57 | 19.1 | 26.65% | 30.54 |
| SFB: Small Finance Bank, Source: Bandhan Bank IPO prospectus | | | | | | | | |

Bandhan Bank: Ratio analysis (FY2017)

| | Return on average assets* (%) | Return on average equity (%) | Net interest margin (%) | Yield on advances (%) | Cost to income (%) | Cost of funds (%) |
|----------------------------------|-------------------------------|------------------------------|-------------------------|-----------------------|--------------------|-------------------|
| HDFC Bank | 1.9 | 17.9 | 4.2 | 10.2 | 43.4 | 5.5 |
| ICICI Bank | 1.3 | 10.3 | 2.9 | 8.8 | 35.8 | 5.3 |
| Axis Bank | 0.7 | 6.8 | 3.2 | 9.3 | 40.9 | 5.4 |
| Kotak Mahindra Bank | 1.7 | 13.2 | 4.0 | 10.5 | 46.7 | 5.7 |
| Yes Bank | 1.8 | 18.6 | 3.0 | 10.6 | 41.4 | 6.5 |
| Indusind Bank | 1.8 | 15.1 | 3.8 | 11.4 | 46.7 | 6.3 |
| IDFC Bank | 1.1 | 7.2 | 2.2 | 10.7 | 42.1 | 8.9 |
| Bandhan Bank | 4.5 | 28.5 | 10.4 | 21.5 | 36.3 | 7.9 |
| Bajaj Finance | 3.2 | 21.6 | 9.4 | 20.2 | 44.2 | 8.8 |
| Gruh Finance | 2.3 | 30.4 | 4.0 | 11.6 | 17.2 | 8.3 |
| Bharat financial Inclusion | 3.4 | 15.1 | 10.1 | 20.1 | 61.9 | 10.1 |
| Satin Creditcare network | 0.6 | 5.1 | 7.1 | 21.8 | 81.7 | 13.2 |
| Grameen Koota Financial Services | 2.4 | 13.0 | 11.3 | 23.6 | 44.5 | 13.2 |
| AU Small Finance Bank | 3.2 | 20.4 | 10.8 | 19.7 | 39.3 | 10.3 |
| Equitas Small Finance Bank | 1.8 | 7.6 | 9.2 | 22.9 | 70.8 | 10.7 |
| Ujjivan Financial Services | 2.9 | 14.1 | 11.4 | 22.0 | 53.6 | 9.8 |
| Janlakshmi Financial Services | 1.3 | 9.4 | 12.0 | 26.0 | 68.1 | 10.4 |

Source: Bandhan Bank IPO prospectus

Bandhan Bank: Financials

| Particulars | 1603 (12) | 1703 (12) | 1612 (9) | 1712 (9) |
|----------------------------|-----------|-----------|----------|----------|
| Interest Earned | 1581.36 | 3908.71 | 2830.37 | 3451.70 |
| Interest Expended | 648.53 | 1505.21 | 1116.60 | 1282.87 |
| Net Interest Income | 932.84 | 2403.50 | 1713.78 | 2168.83 |
| Other Income | 149.89 | 411.41 | 281.98 | 502.81 |
| Net Total Income | 1082.73 | 2814.91 | 1995.76 | 2671.64 |
| Operating Expenses | 615.92 | 1022.01 | 732.94 | 945.34 |
| Operating Profits | 466.81 | 1792.91 | 1262.82 | 1726.30 |
| Provisions & Contingencies | 53.30 | 88.44 | 51.99 | 265.13 |
| Profit Before Tax | 413.51 | 1704.47 | 1210.83 | 1461.18 |
| Provision for Tax | 138.26 | 592.52 | 421.28 | 503.48 |
| Net Profit | 275.25 | 1111.95 | 789.54 | 957.70 |
| EPS*(Rs) | 2.3 | 9.3 | 8.8 | 10.7 |

* Annualised on post issue equity of Rs 1192.80 crore, Face value Rs 10/- Figures in Rs crore
 Bank began operations on 23 August 2015 and figures for FY2016 include micro banking and general banking operations only for the period from 23 August 2015 to 31 March 2016, and accordingly, FY 2016 financial statements are not comparable with FY2017 financial statements.

Source: Capitaline Databases

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