**Elevator Pitch/Summary:**

A well-capitalized retail focused bank[[1]](#footnote-1), operating at the bottom of the pyramid having superior pricing power with decent liabilities profile and good asset quality; bank is increasing lines of business to offer Retail, MSME and affordable housing loans to similar customer base. However susceptible to high % of unsecured loans which is driven by operationally intensive practices, and increase in book driven by increasing exposure per customer and limited digital offerings focused towards customers, making business operationally dependent and prone to tech disruptions.

**Key Metrics**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Bandhan Bank** | **HDFC Bank** | **Kotak** | **ICICI** | **Axis Bank** |
|  | **Q3 FY 20** | **FY 19** | **FY 18** | **FY 19** | **FY 19** | **FY 19** | **FY 19** |
| **Capital** |
| Capital Adequacy | 32.81% | 29.2% | 31.48% | 17.1% | 17.50% | 16.89% | 15.84% |
| CET1 | 31.7% | 27.88% | 30.30% | 14.93% | 16.72% | 15.09% | 12.54% |
| AT1 | 0% | 0% | 0.85% | 0.18% | 13.64% | 11.27% |
| AT2 | 1.11% | 1.32% | 1.18% | 1.33% | 0.52% | 1.45% | 1.27% |
| **Liquidity** |
| **LCR** |  | 150.7% | 95.47% | 117.3% | 123.4% |  | 123.6% |
| Efficiency |
| Cost to Income | 33.4% | 32.6% | 34.6% | 39.7% | 47.4% | 43.6% | 45.4% |
| Opex to Loan Book | 4.21% | 4.94% | 6.29% | 3.54% | 4.00% | 3.29% | 3.39% |
| Business/employee (lakhs) | 309 |  258  |  258  |  1,687  |  996  |  1,222  |  1,653  |
| Profitability |
| RoA | 3.5% | 3.87% | 4.03% | 1.83% | 1.69% | 0.36% | 0.63% |
| RoE | 20.0% | 19.52% | 19.46% | 15.23% | 12.27% | 3.25% | 7.53% |
| Profit/Employee (Lakhs) | 8.59 |  6.00  |  6.00  |  23.00  |  12.00  |  4.00  |  7.61  |
| Pricing |
| Yield | 14.0% | 16.5% | 16.4% | 10.5% | 9.8% | 8.7% | 8.8% |
| Cost of Funds | 7.2% | 5.5% | 6.1% | 5.2% | 5.3% | 4.7% | 5.1% |
| Cost of Borrowing |  | 12.8% | 13.5% | 8.1% | 5.8% | 5.7% | 6.4% |
| Cost of Deposit |  | 5.4% | 5.9% | 4.8% | 5.3% | 4.4% | 4.7% |
| Spread | 6.8% | 11.0% | 10.3% | 5.3% | 4.5% | 4.1% | 3.7% |
| NIM | 7.9% | 8.9% | 8.1% | 4.2% | 3.9% | 2.9% | 2.9% |
| Deposits |
| CASA | 34.4% | 40.8% | 34.3% | 42.4% | 52.5% | 49.6% | 44.4% |
| Retail Deposits as % of overall deposits | 76% | 77.4% | 71.9% |  |  | 60.0% | 78.4% |
| Deposit % (Deposit + Borrowing) | 82% | 99% | 99% | 89% | 88% | 80% | 78% |
| Savings balance per Debit Card (Dec’ 19)[[2]](#footnote-2) | 46713 |  |  | 90051 | 65944 | 46186 | 68194 |
| Advances |
| Term Loans |  | 98% | 98% | 71% | 67% | 69% | 66% |
| Secured Loans |  | 95% | 95% | 73% | 76% | 72% | 72% |
| PSL | 92% | 95% | 95% | 27% | 35% | 29% | 24% |
| Credit-Deposit Ratio | 110% | 92% | 88% | 89% | 91% | 90% | 90% |
| Asset Quality |
| GNPA | 1.93% | 2.0% | 1.3% | 1.4% | 2.1% | 6.7% | 5.3% |
| NNPA | 0.81% | 0.6% | 0.8% | 0.39% | 0.75% | 2.29% | 2.20% |
| Retail Lending | 91.7% | 90.4% | 90.4% | 53.48% | 49.05% | 67.38% | 59.21% |
| SME Lending | 3.2% | 4.4% | 5.5% | 23.49% | 18.43% | 0.00% | 5.67% |
| Corporate/Wholesale Lending | 5.1% | 5.1% | 4.0% | 23.03% | 32.51% | 32.62% | 35.12% |
| Advances per Branch (in Lakhs) | 309.42 | 258.00  | 232.00  | 1,687.00  | 996.00  | 1,222.00  | 1,653.00  |
| PCR |  | 72% | 54% | 71% | 65.40% | 70.6% | 77% |
| RoA Tree |
| Interest Income |  | 13.2% |  | 8.6% | 8.3% | 6.9% | 7.4% |
| Interest Expense |  | 4.3% |  | 4.4% | 4.4% | 3.9% | 4.5% |
| NIM |  | 8.9% |  | 4.2% | 3.9% | 2.9% | 2.9% |
| Other Income |  | 2.1% |  | 1.5% | 1.6% | 1.6% | 1.8% |
| Net Income |  | 11.0% |  | 5.7% | 5.5% | 4.5% | 4.7% |
| Operational Expenses |  | 3.6% |  | 2.3% | 2.6% | 2.0% | 2.1% |
| Provision & Contingencies |  | 1.6% |  | 1.6% | 1.2% | 2.2% | 1.9% |
| RoA |  | 5.9% |  | 1.8% | 1.7% | 0.4% | 0.6% |

|  |
| --- |
| **Business Slotting:** Customer: 🗹 Retail 🞎 SME 🞎 Corporate 🞎 WholesaleNature of Loans: 🞎 Secured 🗹 UnsecuredMajor lines of business: 🗹 Personal Loans 🗹 Home Loans 🞎 Auto Loans 🞎 Two Wheeler Loans 🞎 Credit Card 🞎 Agri Loans 🞎 Gold Loans 🞎 Working Capital – SME 🞎 Term Loan – SME 🞎 Corporate Loans 🞎 On-LendingOperating Model: 🗹 Branch 🞎 Digital 🞎 PhygitalCustomer: 🗹Bottom of Pyramid 🗹 Lower/Aspiring Middle Class 🞎 Middle Income 🞎 High IncomePricing/NIMs: 🗹 Very High 🞎 High 🞎 Medium 🞎 Low |
| **Company Background**The company started as Bandhan Konnagar in 2001, post which it transferred its business under the NBFC structure. The company was solely focussed on providing MFI loans within the rural areas in the eastern part of the country. As part of the universal bank licenses awarded by the RBI in 2012-13, Bandhan along with IDFC were the two players who got the go-ahead to form the universal bank, and in 2015 Bandhan started its universal banking operations, by which time, it was the biggest MFI lender in India.*Pre-Bank:*The company was started by CS Ghosh and he has been the driving force behind the development of the “Bandhan” brand as well as its business. The company managed its MFI business (and still does) under the Joint Liability Group model (refer Business Model for details), and focussed primarily in the eastern part of India operating in West Bengal. While the MFI industry suffered a downturn during the AP crisis of 2010, Bandhan was able to further strengthen its business and from being the fourth largest MFI in 2010, it became the largest MFI by March 2012.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2012 | 2013 | 2014 | 2015 | Q1 FY15-16 |
| GLP (Cr.) | 3,730 | 4,420 | 6,107 | 7,809 | 10,242 |
| Branches (#) | 1,553 | 1,803 | 2,016 | 2,022 | 2,022 |
| Customers (mn) | 3.6 | 4.4 | 5.4 | 6.5 | 6.7 |
| CREs | 7,178 | 8,719 | 9,954 | 10,110 | 10,110 |
| Avg. O/S |  10,361  |  10,045  |  11,309  |  12,014  |  15,287  |
| Industry |
| GLP (Cr.) | 16,813 | 17,407 | 24,862 | 40,138 | 36,767 |
| Clients (mn) | 20.66 | 19.42 | 23.68 | 30.5 | 26.4 |
| Bandhan as % of MFI industry |
| GLP | 22.2% | 25.4% | 24.6% | 19.5% | 27.9% |
| Clients | 17.4% | 22.7% | 22.8% | 21.3% | 25.4% |

Bandhan continued its position of strength right till it converted into a bank in Q2 FY15-16 and constituted ~ 28% of the MFI industry when it transitioned into a bank.*Post conversion into Bank:*After Bandhan converted into a Bank, all the lending business of Bandhan MFI was transferred to the Bank’s loan book. In line with it’s DNA, Bandhan Bank continued growing its MFI loan book through geographic expansion along with increasing the avg. exposure per client (since it was no more bound by the MFIN and RBI guidelines which were applicable on it as an NBFC-MFI). Unlike NBFC-MFIs which have a 10% margin cap, a bank operating in the MFI space, is not limited by this 10% margin cap, and therefore Bandhan potentially had the option to keep charging the customers a higher interest rate. However, Bandhan chose to reduce its lending rates and currently offers MFI loans at 17.5% rate across India, passing the benefit of lower cost of funds to its MFI customers *(which is what an avg. credit profile customer would get from a bank as a personal loan)*.However, unlike other banks which offer a large portfolio of loan products, which are a mix of both secured and unsecured loan book, Bandhan’s book (till end of FY19) remained dominated by the MFI loan book, and majority of the other loans that Bandhan has, is also offered primarily to its MFI customers (except corporate/NBFC-MFI/SME loans which are less than 10%). Till the acquisition of Gruh Finance the balance 4% [100-86 (MFI)-10(NBFC/Corporate)] comprised of personal loans and loans against deposits (~3% of the loan book).MFI Loan Book

|  | 2016 | 2017 | 2018 | 2019 | Q3 FY 20 |
| --- | --- | --- | --- | --- | --- |
| Micro Loan (Cr.) | 15,420 | 21,390 | 27,650 | 38,600 | 40,100 |
| DSC (#) | 2,022 | 2,443 | 2,764 | 3,014 | 3,084 |
| Customers (mn) | 6.36 | 6.83 | 7.7 | 9.49 | 10.5 |
| Avg. O/S | 24,245 | 31,318 | 35,909 | 40,674 | 38,190 |
|  |  |  |  |  |  |
| MFI loans as % of total loan book | N.A. | 91% | 86% | 86% | 61% |

*Gruh acquisition:*In 2019, facing regulatory forbearances (requirement of taking RBI approval for branch expansion, no hike in salary of the CEO) due to shareholding of the promoter remaining >40%, Bandhan Bank acquired GRUH finance as part of a share swap deal. The transaction was consummated on Q2 FY20, post which mortgage lending was established as a business unit within Bandhan Bank and became 29% of the overall portfolio.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | FY 16 | FY 17 | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 |
| Micro |  | 91% | 89% | 87% | 88% | 86% | 86% | 87% | 86% | 86% | 86% | 61% | 61% |
| Retail |  | 2% | 2% | 3% | 3% | 4% | 3% | 3% | 3% | 4% | 4% | 1% | 1% |
| Mortgage |  | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 1% | 0% | 0% | 30% | 29% |
| SME |  | 8% | 9% | 10% | 6% | 6% | 6% | 5% | 4% | 4% | 4% | 3% | 4% |
| Corporate |  | 0% | 0% | 0% | 3% | 4% | 5% | 5% | 5% | 5% | 6% | 5% | 5% |

As the transaction has been recently completed, the management is focussed on handling the post-merger integration activities and thus no branch expansion of Gruh has happened, however certain Bandhan Bank branches have been activated to offer mortgage loans as part of Bandhan Bank’s affordable housing play.It may also be noted, that while the Gruh txn happened after the RBI sanctions, Bandhan was interested in Gruh transaction earlier as well, about two years before the actual transaction. However at that time either HDFC wasn’t willing to sell, or Bandhan wasn’t desperate enough and the deal didn’t move through, therefore what can be said is that this isn’t a transaction which was done in the heat of the moment, but something which was accelerated due to the sanctions.It may however be noted, that both the MFI and Affordable Housing loans are operationally heavy businesses and thus the growth in overall business will be driven by:1. Branch expansion (restricted by RBI) – The model cannot be digitized by eliminating branches unlike a credit card or a personal loan product
2. Enabling cross-selling between Gruh and Bandhan customers (overlap between customers and ability to cross-sell yet to be ascertained)
3. Apart from Gruh business and the SME loans, Bandhan’s loan book is essentially a MFI loan book, and will suffer the challenges that other MFIs would suffer with respect to customer behaviour
 |
| **Management & Governance**Experienced across multiple business cycles: 🞎 No 🗹 YesComposition of board: 🞎 Management dominated 🗹 Major independent board members |
| 1. **Chandra Shekhar Ghosh** is the main person who has developed the Bandhan business and is currently the CEO of the Bandhan Bank. He has over 27 years of experience in the field of microfinance and operations. As part of the business/operations review, he still visits the customer and meeting centres to understand the pulse of the business. Having run the business since 2001, he has managed the multiple business cycles and has continued the business momentum while managing the asset quality. Post the IPO, Mr. Ghosh held 80% of the share in Bandhan Bank and post Gruh transaction still owns ~60% shareholding, which makes his interest aligned to the shareholders.

As the bank license review process involves scrutiny of the entity as well as the main people behind the entity, it is safe to assume that till 2014-15 Mr. Ghosh had a clean track record not involving any criminal cases or governmental investigations against him, and it may also be safe to assume that he is at present considered as a fit-and-proper candidate to head the bank. While I haven’t read the book “Bandhan: The making of a Bank” from what I have heard about Mr. Ghosh from the book is that he is an extremely cost-conscious business leader (which is good in MFI environment where margins are fixed) but he’s also a micro-manager (which might not be so good as the bank grows). Mr. Ghosh has admitted that he understand the MFI business but doesn’t understands the housing business, and therefore hasn’t intervened in the way Gruh operates its lending business/practices/controls, which is a good sign of Mr. Ghosh letting go of some of the micro-managing activities in area where he doesn’t have the competencies. THIS MAY BE AN AREA TO SEE IF GRUH PRACTICES UNDERGO CHANGE GOING FORWARD TO ALIGN WITH THE BANDHAN DNA.**Compensation:** Unlike non-financial companies, the Nomination and Remuneration Committee recommends compensation of the CEO and the RBI is required to approve the compensation and is paid in arrears. As per the DRHP “Further, pursuant to RBI letter dated August 11, 2017, Chandra Shekhar Ghosh is also entitled a variable payment of 35% of annual fixed pay for the Fiscal 2016, with 50% of the variable payment to be paid in the Fiscal 2017 and the balance in two equal instalments of 25% each in April 2017 and April 2018.” As per guidelines, the overall limit for CEO salary is 5% of Net Profit, and the compensation is well within the guidelines, which is a well aligned with the shareholders.

|  | **2016** | **2017** | **2018** | **2019** |
| --- | --- | --- | --- | --- |
| PAT (Cr.) | 275 | 1327 | 1,345 | 1,951 |
| CEO Salary (Cr.) |  |  |  |  |
| Salary + PF | 1.1 | 1.94 | 2.39 | 2.04 |
| Deferred | Not Available | Not Available | 0.27 | Not Available |
| ESOP |  | 0 | 0.02 | 1.49 |

**One Red Flag: Involvement of relatives in the business**“*Dibakar Ghosh, brother of Chandra Shekhar Ghosh has been appointed as the Head of IT Operations- Systems and Networking of our Bank with effect from August 23, 2015, and Vaskar Ghosh, brother of Chandra Shekhar Ghosh has been appointed as the Head- Procurement of our Bank, with effect from August 23, 2015.*“ – Source DRHPApart from Mr. Ghosh, all the key personnel seems to be lateral hires who joined the bank in 2015, 2016 from a mix of private and public sector banks. While lateral hiring improves the competencies and brings the best practices and knowledge, but there would have been some change management issues, which would have gotten settled by now.1. **Sudhin Bhagwandas Choksey** he has led the Gruh business as the MD for the independent Gruh business, and is now the ED-Designate within Bandhan and continues to lead the Gruh/affordable housing business. His presence and ability to handle down-turns will additionally play well for the growth of the business.

**Board:** In line with the RBI guidelines, the board at Bandhan comprises of majority of independent directors and have extensive experience in banking (MD of Union Bank, DMD Axis Bank, ex-RBI, Director IDRBT) which provides comfort on the governance practices followed at the board level. |
| **Customers**Customer: 🗹 Retail 🞎 SME 🞎 Corporate 🞎 WholesaleIncome Segment: 🗹 Bottom of Pyramid 🗹 Lower/Aspiring Middle Class 🞎 Middle Income 🞎 High IncomeLoan Book Driver: 🗹 Increase customer base 🗹 Increasing exposure 🗹 Changing customer mix |
| The customers to whom Bandhan lends includes:1. Retail MFI customers
2. Small Business Enterprises
3. SMEs
4. Corporate
5. NBFC & NBFC-MFIs
6. Affordable Housing
7. MFI Customers: Typical MFI customers are a bottom of pyramid customers (household income < 1.6 Lakh) who come together to form a group and take the joint liability of paying the loan disbursed to the group members (NOTE: The loan is disbursed to an individual member, but the liability is at group level). Unlike other banks which try to serve the MFI loans under the Self Help Group model, Bandhan has been continuing with its model of lending to MFI customers (As per Bandhan mgmt., micro loans are loans given upto 1.5 Lakhs) through the JLG model Due to its lineage, Bandhan has customers which have been therefore for over 19 years with Bandhan and their requirements have also grown over a period of time (avg. age of customer with Bandhan 7-8 years), leading to demand for higher ticket sizes, which Bandhan has been able to fulfil post becoming a bank.

While Bandhan was a MFI, it was limited by the RBI and MFIN guidelines of not lending to customer such that the overall borrowing crosses 80,000; however post conversion into a bank, Bandhan has started increasing its book by mix of both increasing customer base as well as increasing avg. O/S.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Q3 FY20 | CAGR |
| GLP (Cr.) | 3,730 | 4,420 | 6,107 | 7,809 | 15,420 | 21,390 | 27,650 | 38,600 | 40,100 |  |
| Customers (mn) | 3.6 | 4.4 | 5.4 | 6.5 | 6.36 | 6.83 | 7.7 | 9.49 | 10.5 |  |
| Avg. O/S | 10,361 | 10,045 | 11,309 | 12,014 | 24,245 | 31,318 | 35,909 | 40,674 | 38,190 |  |
| Growth Rates |  |
| GLP |  | 18.5% | 38.2% | 27.9% | 97.5% | 38.7% | 29.3% | 39.6% | 3.9% | 35.9% |
| Customer |  | 22.2% | 22.7% | 20.4% | -2.2% | 7.4% | 12.7% | 23.2% | 10.6% | 14.8% |
| Avg. O/S |  | -3.0% | 12.6% | 6.2% | 101.8% | 29.2% | 14.7% | 13.3% | -6.1% | 18.3% |

From the above trend, it is coming out clearly that while there is a growth of customer base, larger chunk of growth is being driven by increase in average outstanding. The avg. O/S is among the highest vis-à-vis MFIs with Grameen Koota having an avg. O/S of 30.2K. This increase in average outstanding is something that industry has been blaming for the situation in Assam (16% of Bandhan’s portfolio) leading to overall stress among borrowers. OVER-LEVERAGING OF CUSTOMER A BIG RISK FACTOR. Bandhan follows a policy of one loan per customer, and therefore from a trending perspective they would lend a higher loan amount upfront which crowds out the NBFC-MFIs as they have to adhere to the 80K limitation. However NBFC-MFI, SFBs (SFBs also don’t need to comply with the 80K limit) have found a way around, where they would approach Bandhan customers once say half of the loan has been paid off and offer loans to the customer at that time. This can be seen from the fact that the number of unique customers have gone down (refer table below)

|  |  |  |
| --- | --- | --- |
| Q4 FY 19 | Q1 FY 20 | Q3 FY 20 |
| 72% | 60% | 55% |

Therefore there is encroachment in the customer base of Bandhan with MFIs/SFBs attracting customers. As of Q3 FY20 55% of customers are exclusive Bandhan Bank customers with customer retention increasing from 88% in Q4 FY 18 to 91% in Q4 FY19, with 55% customer being with Bandhan for over four cycles (comprising 65% of the micro-loans loan book).OVERLAP OF THESE CUSTOMER FROM LIABILITY PERSEPCTIVE: The MFI customers contribute ~ 6% of the deposit (~90% of which is CASA), and thus there is very limited overlap between the assets side and liabilities business, which the management tells is an informed decision of the bank as they don’t want to mix the assets strategy with the liabilities strategy making the loan officers and customer life difficult (refer Liabilities section)1. Small Business Enterprises: These are essentially MFI customers only who have grown their business, but don’t have any formal documentation to qualify/become a MSME. These would be typical manual work/handicraft/shops/self-prop, and therefore their behaviour may not differ from a typical MFI customer except for the following:
	1. Loans are purely given on individual underwriting methodology
	2. Loans may or may not be secured
	3. Loan ticket would be even higher than the micro-loans (avg. O/S 1.84 lakhs)
2. MSME: This is new business/customer segment that Bandhan has entered post becoming a bank. There is no specific segment that the bank has identified/highlighted as the type of MSME customer or industry that they operate in. From the limited disclosures with respect to the MSME book, the MSME book is also focussed on the smaller end of the MSME which qualify under the priority segment. The avg. O/S for SMEs is 28.7 Lakhs.
3. Corporate: The bank experimented with the corporate lending line of business and gave loans to IL&FS. However post the IL&FS debacle, the management has written off the whole loan, and has stated that it is not looking to re-enter this segment soon. Therefore no more a relevant customer segment for Bandhan.
4. NBFC and NBFC-MFI: This is similar to the typical on-lending done by banks, where banks lend to NBFC and NBFC-MFIs, which is typically done by banks for PSL compliance. However in the case of Bandhan there is no clear reason why this is being done as they are already in PSL surplus. The NIM earned by Bandhan by lending to these NBFCs typically ranges ~6% and adding the PSLC income, Bandhan is potentially making 1% therefore earning 7%. However the underlying business is still exposed to the MFI customers. Therefore not much in customer profile diversification.
5. Affordable Housing: GRUH before merger with Bandhan focussed on the rural and semi-urban areas by focussing on the Taluka level geographies. ~40-45% of the loan book comprised of customers staying in rural areas (population less than 50,000) taking a loan of 7-8 Lakhs paid over 15-20 years. Therefore the EMI would approx.. be in the range of 7-8K. Therefore the customer would be more a lower band of an SME or lower income group customers (also supported by the fact that some of home loans were eligible under the Pradhan Mantri Awas Yojna). Therefore there is a likelihood that with the GRUH and Bandhan combined, there is a small overlap between customer segments (more like SEL customers) and thus becomes a critical independent customer base.
6. Liability Customer segment: Nothing specific has been mentioned by the management to give any color on the specific customer segment which is contributing to the liability base. However from the avg. deposits being maintained by the customers, it doesn’t appears to be the middle class and higher segments.
 |
| **Business Model**Operational Complexity: 🗹 Low 🞎 Medium 🞎 HighScalability driver: 🗹 Branch 🞎 On-line 🞎 PhygitalPricing Power: 🗹 High 🞎 Medium 🞎 LowAsset Profile: 🞎 Short (1-2 year) 🗹 Medium (3-4 years) 🞎 Longer (5+ Years)Liability Profile: 🞎 Short (1-2 year) 🗹 Medium (3-4 years) 🞎 Longer (5+ Years) |
| **Corporate Structure:**The business has been structured into three divisions:1. The MFI business which would look purely into the MFI business
2. General Banking which would cover the non-MFI/JLG lending and liability business
3. Gruh/Housing business which is being led by Mr. Choksi and should reflect the continuation of the same practices

**Business Model:** Like in a typical lending business, Bandhan borrows money of its depositor and lends to its customers at a higher rate. Up-until the acquisition of Gruh Finance, the business had very simple to manage asset-liabilities. It used to raise deposits in short (CASA) and medium (FDs) and lend for a short duration (1-2 years) through unsecured loans in the JLG model (“*Micro Loans Granted for ₹25,000 or more are considered as secured loans as the underlying loan agreements include a clause of hypothecation whereby all movable goods procured by the borrowers from time to time from the proceeds of loan are hypothecated in favour of the Bank by way of a first and exclusive charge.*” – However not sure how much of it is enforceable). Given the lack of last-mile alternatives and nature of lending, Bandhan used to price loans at a steep NIM vis-à-vis other lenders of 10% and out of this ~3-4% would go into the operating expenses and ~1% would go in loan losses. In addition to this, the bank used to sell PSLCs to other banks and earn ~1% additional income on the loan book in excess of 40% PSL requirement of its, given its loan book was ~96% PSL compliant, Bandhan was able to realize additional 1% on ~60% of its book [PSL requirement is computed as ~40% of the last year’s loan book]However post the acquisition of Gruh, the business model has undergone the following changes:1. Secured loan book % has increased dramatically
2. Due to the nature of higher mortgage loans, the interest margins have reduced
3. The % of loan book which qualifies for PSLC sales has come down, however the quantum has increased
4. The bank had to raise longer duration liabilities which the bank did majorly through longer duration FDs

**NOTE**: Q2FY20 is consolidated business including Gruh

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 | HDFC | Kotak | ICICI | Axis | SBI |
| Yield | 16.7% | 15.1% | 15.4% | 14.6% | 15.4% | 15.3% | 15.4% | 15.6% | 15.7% | 14.2% | 14.0% | 10.5% | 9.8% | 8.7% | 8.8% | 7.9% |
| Cost of Funds | 7.0% | 6.7% | 6.8% | 6.2% | 6.5% | 6.3% | 6.3% | 6.1% | 6.6% | 7.2% | 7.2% | 5.2% | 5.3% | 4.7% | 5.1% | 4.8% |
| Spread | 9.7% | 8.4% | 8.6% | 8.4% | 8.9% | 9.0% | 9.1% | 9.5% | 9.1% | 7.0% | 6.8% | 5.3% | 4.5% | 4.1% | 3.7% | 3.0% |
| NIM | 10.8% | 9.3% | 9.6% | 9.3% | 10.3% | 10.2% | 10.5% | 10.7% | 10.5% | 8.2% | 7.9% | 4.2% | 3.9% | 2.9% | 2.9% | 2.5% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Gruh NIM | 4.4% | 4.4% | 4.4% | 4.4% | 4.3% | 4.1% | 3.9% | 4.0% | 3.8% |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| CASA% | 26.3% | 28.2% | 33.2% | 34.3% | 35.5% | 36.9% | 41.4% | 40.8% | 36.1% | 32.9% | 34.4% | 42.4% | 52.5% | 49.6% | 44.4% | 44.6% |
| Retail Deposits | 75.7% | 76.1% | 85.1% | 71.9% | 80.0% | 81.6% | 84.8% | 77.4% | 76.1% | 78.0% | 76.2% |  |  | 60.0% | 78.4% |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| RoA | 4.40% | 4.20% | 3.70% | 4.10% | 4.50% | 4.30% | 2.90% | 5.20% | 4.89% | 4.80% | 3.50% | 1.83% | 1.69% | 0.36% | 0.63% | 0.02% |
| RoE | 28.1% | 26.4% | 22.5% | 27.7% | 19.9% | 19.2% | 12.5% | 24.1% | 24.4% | 28.3% | 20.0% | 15.2% | 12.3% | 3.3% | 7.5% | 0.4% |

Therefore on an on-going basis the following changes can be expected in the business model:1. Lower NIMs of ~7.9-8% leading to lowering RoA compared to year ago NIM and RoA metrics
2. Bank has to increase longer duration borrowings to support the growth of Gruh business (through sub-ordinate debts or Tier-II instruments); inability can potentially lead to asset-liability mismatch

**Operating Model** – The operating model of the Bank can be broadly divided into two categories:1. MFI business operating model
2. Gruh Housing operating model

MFI business: Bandhan operates a hub-and-spoke model, where in 3-4 DSCs (Doorstep Service Centers/MFI business outlets) are associated with a branch. The DSCs are manned by 5-6 loan officers and 1 branch manager and one loan officer would typically handle 600 customers. The loan officer visits the customers weekly for new business and collections and is able to interact with the customer and get a ground level visibility about the customer’s financial health (the customer typically operate feature phones, therefore no smartphone based SMS scrapping possible to get visibility remotely); Behind the branches, there is a typical regional, zonal hierarchy driving and providing oversight on the lending operations.“*Bandhan has a four tier system at the field: Branches, Regions, Divisions and Zones, with clearly defined roles and responsibilities for each officer at all levels. The branch, being the lowest unit, serves as a residence for the field staff and a central point from where field operations are coordinated and managed. Six to seven branches form a region, headed by a Regional Manager, while five to six regions form a division, headed by a Divisional Manager. Four to five divisions constitute a zone. Each zone is headed by a Deputy General Manager, who, along with one assistant manager and one senior officer, monitors the zone. Although the zonal heads operate from the head office, they spend most of their time in the field.*”All of this makes the operating model very operationally heavily, which while can be scaled-up quickly, but can’t be digitized except for the following:1. Digitizing back-end of loan officer side of activities eg. Using tablets for improving efficiency wrt to data entry, audit tracking etc.
2. Making the loans more individual based rather than group based (eg. CreditAccess Grameen has 5% of portfolio given to individuals who were earlier JLG members)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 |
| Branches | 840 | 864 | 887 | 936 | 937 | 938 | 978 | 986 | 999 | 1000 | 1009 |
| DSC | 2444 | 2546 | 2633 | 2764 | 2764 | 3010 | 3014 | 3014 | 3014 | 3025 | 3084 |
| Gruh |  |  |  | 194 | 194 | 194 | 195 | 195 | 196 | 195 | 195 |
| Banking Outlet | 3284 | 3410 | 3520 | 3700 | 3701 | 3948 | 3992 | 4000 | 4013 | 4220 | 4288 |
| Loan Book (in Rs. Bn.) |
| Non Gruh |  217.2  |  226.1  |  243.6  |  321.4  |  325.9  |  333.7  |  356.0  |  447.8  |  454.2  |  449.9  |  463.2  |
| Gruh |  -  |  -  |  -  |  -  |  -  |  -  |  3  |  -  |  -  |  192  |  191  |

 Pre AcquisitionGruh: Gruh also follows a branch led operating model, where the loan officer does the credit evaluation of the customer. Given the customer that Gruh typically lends to, there is limited documentation available and therefore the process is again manually intensive, less open to digitization and therefore similar to Bandhan’s operating model. The advantage that the Bandhan transaction provides Gruh is that it possibly allows Gruh to open more branches (which it wasn’t doing for a long period, which may be some tatic understand with HDFC expanding its network and Gruh trying to getting more business from the existing branches which in a way led to better P&L - this is a hypothesis, no fact backing it ).

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | FY 17 | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 |
| RoA | 2.37% | 2.09% | 2.12% | 2.15% | 2.45% | 2.86% | 2.57% | 2.50% | 2.66% | 2.58% | Merged |
| RoE | 30.00% | 26.40% | 26.40% | 28.80% | 28.79% | 31.06% | 27.27% | 25.42% | 25.92% | 23.71% |

From a business model and expected returns perspective, as the mortgage portfolio’s composition increases as a % of the total portfolio, the RoA of Bandhan Bank can be expected to stabilize at current levels if the same mix is maintained, while the RoE can be expected to remain in the range of 24-25% (RoE of Gruh would reduce a bit as it has to start following the banking rules with respect to provisioning)In effect, Bandhan seems to be closer to a unsecured lending NBFC (e.g. Bajaj Finance) operating at the lower end of the affluent customer segment, with Gruh transaction helping it to develop additional lines of business. |
| **Balance Sheet – Liabilities**CASA Franchise: 🞎 Strong 🗹 Medium 🞎 WeakCASA Nature: 🗹 Granual/Retail 🞎 Bulk DepositCASA Value Prop: 🗹 Higher Interest Rate 🞎 Primary Account 🗹 Not ClearCustomer Profile: 🗹 Unclear 🞎 Agri 🞎 Salaried 🞎 SME 🞎 Corporate |
|

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| (In Rs. Bn) | FY 16 | FY 17 | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 |
| Deposit | 120.9  | 232.3  | 224.4  | 254.4  | 252.9  | 338.7  | 437.0  | 329.6  | 346.4  | 432.3  | 437.0  | 492.0  | 549.1  |
| Borrowing | 30.5  | 10.3  | 8.5  | 8.1  | 13.3  | 2.9  | 4.6  | 14.2  | 2.6  | 5.2  | 165.2  | 165.2  | 119.6  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Deposits | 120.9 | 231.4 | 224.4 | 254.4 | 252.9 | 338.7 | 307.0 | 329.6 | 346.4 | 432.3 | 437.1 | 491.9 | 549.9 |
|  CA | 2.4 | 14.5 | 11 | 12.88 | 14.85 | 24.15 | 20.72 | 21.05 | 29.2 | 36.1 | 29.23 | 26.55 | 28.3 |
| SA | 23.7 | 53 | 48.09 | 58.82 | 69.17 | 92.09 | 88.15 | 100.7 | 114.2 | 140.1 | 128.3 | 135.3 | 160.9 |
| TD | 94.8 | 163.9 | 165.3 | 182.7 | 168.9 | 222.4 | 198.1 | 207.8 | 202.9 | 256.1 | 279.4 | 330.1 | 360.7 |
| TD - Retail | 19.8 | 95.9 | 110.9 | 121.9 | 131.2 | 127.4 | 136.8  | 147.3 | 150.3 | 158.3 | 174.9  | 221.9  | 229.8  |
| TD - Other | 75 | 68 | 54.4 | 60.8 | 37.8 | 95.1 | 61.4 | 60.6 | 52.7 | 97.8 | 104.5  | 108.2  | 130.9  |
| CASA % | 21.6% | 29.2% | 26.3% | 28.2% | 33.2% | 34.3% | 35.5% | 36.9% | 41.4% | 40.8% | 36.1% | 32.9% | 34.4% |
|   |  |  |  |  |  |  |  |  |  |  |  |  |   |
| Retail to Total Deposits | 37.9% | 70.6% | 75.7% | 76.1% | 85% | 72% | 80% | 81.6% | 84.8% | 77.4% | 76.1% | 78% | 76.2% |
|   |  |  |  |  |  |  |  |  |  |  |  |  |   |
| Avg. balance (in ‘000s) |
| General Banking |  |  |  29.52  |  31.72  |  29.87  |  36.10  |  34.00  |  34.93  |  37.13  |  40.69  |  35.08  |  34.95  |  40.25  |
| Micro Banking |   |   | 1.21  | 1.39  | 1.29  | 2.10  | 1.56  | 1.73  | 1.96  | 2.35  | 2.01  | 1.99  | 1.91  |

Upon commencement of the banking operations, while Bandhan grew its MFI business, it didn’t expand into new asset lines, but rather focused on building the liability side of the balance sheet, and did a commendable job of reducing borrowings to almost 0 by end of FY 19. Unlike trying to build the liabilities through bulk deposits, Bandhan was able to develop a very granular book, as reflected by a high % of retail deposits as well as a high CASA ratio. The following table reflects Bandhan’s CASA and retail book against other leading banks and IDFC First to reflect the good performance that Bandhan exhibited during this build up phase.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Bandhan Bank | HDFC Bank | Kotak Bank | Axis Bank | SBI | IDFC |
|  | Q3 FY 20 | FY 19 | FY 18 | FY 19 | FY 18 | FY 19 | FY 18 | FY 19 | FY 18 | FY 19 | FY 18 | FY 19 | FY 18 |
| CASA | 34.4% | 40.8% | 34.3% | 42.4% | 43.5% | 52.5% | 50.8% | 49.6% | 51.7% | 44.4% | 53.8% | 12.9% | 11.8% |
| Retail Deposit % Deposits | 76.2% | 77.4% | 71.9% |  |  |  |  | 60.0% | 57.0% | 78.4% | 84.9% |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Deposit % Liability | 82% | 99% | 99% | 89% | 86% | 88% | 88% | 80% | 75% | 78% | 75% | 42.2% | 38.1% |
| Cost of |
| Deposit |  | 5.44% | 5.89% | 4.80% | 4.58% | 5.26% | 5.11% | 4.73% | 4.42% | 4.99% | 5.71% | 6.58% | 5.97% |
| Borrowing |  | 12.8% | 13.47% | 8.06% | 7.48% | 5.82% | 5.53% | 6.26% | 6.31% | 3.72% | 2.92% | 7.61% | 8.36% |
| Funds | 7.20% | 5.51% | 6.06% | 5.20% | 4.93% | 5.33% | 5.16% | 5.11% | 4.85% | 4.84% | 5.36% | 7.11% | 7.28% |

It can be seen that by end of FY 19, Bandhan was able to establish a good deposit franchise, which completely funded its lending operations at a cost similar to Kotak Mahindra, however the limited track record the sub-ordinate debt came at a high cost of 13-14%. It is only in FY 20, when Bandhan had to raise bulk deposits to support the assets that were expected to come once Gruh’s business was consolidated into the business, and therefore both the CASA dipped as well as the retail deposits dipped as well as increase its borrowings. In order to sustain the Gruh business, Bandhan will have to continue borrowing as well increase long-term liabilities either through long term FD or issuing sub-ordinate debt which would difficult or expensive in the current economic situation. Bandhan also took a call to not mix its deposit business from its assets business and the MFI customer contribute only 6% of its overall deposits. “*What has happened there, we are principally from beginning decided on that this is the credit, this is focused only the credit not the deposit. The bank branch deposit has not that much credit because if I give the focus target of the deposit, this people will like to change their mind and my credit quality will come down, so they are focused on the credit and not the deposit. Whatever the habit they have weekly giving of Rs. 10 or Rs. 20 or Rs. 50 above their installment that will come as a balance of the deposit, so for that reason it is there, no target we have given. Otherwise, sometimes they will be disbursed the loan and put in the account and not given the chance to withdraw then the deposit will come high, so we are very careful about that point so that we are happy this 7% or 8% of the total deposit, even 10% will come maximum.”*The other advantage that this strategy provides that in case of any adverse situation, bad asset quality will not spill into its liability side of balance sheet.However, from the management commentary it is not clear/understood that if the CASA account has any driver or transacting nature kind of benefits, which would make customers shift to making Bandhan as their primary banking account, except a higher interest rates (Bandhan offers 6% interest rate for balances above 1 Lakh). Also there is no clarity on what is the profile of the customer that is depositing balances in Bandhan, therefore sustainability or it or any malpractice can’t be commented upon.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Bandhan Bank | HDFC Bank | Kotak | ICICI Bank | Axis Bank | SBI Bank |
|  | FY 19 | FY 18 |  |  |  |  |  |
| % of advances to top 20 depositors |  |  | 6.1% | 12.24% |  | 11.83% | 3.11% |

 |
| **Balance Sheet – Assets**Nature of loans: 🗹 Unsecured (>60%) 🞎 SecuredNature of customers: 🗹 Retail (>90%) 🞎 MSME 🞎 Corporate 🞎 Project FinanceTenor: 🗹 Short (<3 Years, ~70%) 🞎 Medium (3-5 Years) 🗹 Long (>5 Years)Pricing Power: 🗹 Yes 🞎 No |
| **Bandhan’s stated strategy for the bank is that it wants to be in Microfinance, MSME & Affordable Housing.**Through the acquisition of Gruh, Bandhan has established presence in the three verticals that it wanted to do, and therefore tracking of the MSME business growth is the unknown as the management knows the in and outs of the Housing business as well as the MFI business.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 | HDFC | Kotak | ICICI | Axis |
| Micro | 89% | 87% | 88% | 86% | 86% | 87% | 86% | 86% | 86% | 61% | 61% | 47% | 29% | 33% | 40% |
| Retail (ex-Micro, Mortgage) | 2% | 3% | 3% | 4% | 3% | 3% | 3% | 4% | 4% | 1% | 1% |
| Mortgage | 0% | 0% | 0% | 0% | 0% | 0% | 1% | 0% | 0% | 30% | 29% | 7% | 20% | 34% | 19% |
| SME | 9% | 10% | 6% | 6% | 6% | 5% | 4% | 4% | 4% | 3% | 4% | 23% | 18% | 6% | 11% |
| Corporate | 0% | 0% | 3% | 4% | 5% | 5% | 5% | 5% | 6% | 5% | 5% | 30% | 30% | 27% | 30% |
| Wholesale |  |  |  |  |  |  |  |  |  |  |  | 2% |

While Bandhan has a higher retail loan book, it may be noted that for other banks, these loans includes secured loans such as auto loans, gold loans etc., whereas for Bandhan it is purely unsecured loans which makes it susceptible to higher delinquencies in tough economic situation as well as a shorter duration means that these loans will have to be renewed every 1-2 year just to maintain status-quo1. MFI business:
	1. Bandhan has continued focusing on growing its MFI business and inspite of not being limited by the margin cap limitation, Bandhan has passed on the benefits of low cost funding to its customers and has reduced its MFI lending rates from 22.5% to 17.95% which is the lowest among the players operating in the MFI domain. It also builds a strong moat as the rates are lower than what an NBFC would charge people in urban areas with good credit history, and therefore it keeps the competition away.
	2. Bandhan follows a cycle based increase in loan ticket size, there is a restriction on the Rs. 20,000 per customer in the first cycle which can increase between Rs. 10,000 to 30,000 maximum. They also follow one loan per customer, which as a policy makes its customer open to be targeted by other MFIs which has led to reducing in the unique customer base
	3. However as highlighted earlier, Bandhan has been able to retain its customer and increase the avg. exposure per customer which has helped Bandhan to grow its loan book
	4. However the nature of loan (unsecured), limited geographical diversification ( 42% loan book in East and North East even after Gruh transaction), banking outlets still present in East and North East therefore loan book is likely to remain East and North East focused.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 |
| **Banking Outlets by Demographics** |
| Metro | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% |
| Urban | 19% | 19% | 18% | 19% | 19% | 19% | 20% | 20% |
| Semi-Urban | 34% | 34% | 35% | 35% | 35% | 35% | 35% | 35% |
| Rural | 37% | 37% | 37% | 36% | 36% | 36% | 35% | 35% |
| **Banking Outlets by Geography** |
| East | 52% | 53% | 51% | 51% | 51% | 51% | 49% | 49% |
| North East | 15% | 11% | 14% | 14% | 14% | 14% | 13% | 13% |
| Central | 15% | 16% | 17% | 15% | 16% | 16% | 17% | 17% |
| North | 6% | 7% | 6% | 6% | 6% | 6% | 6% | 6% |
| West | 9% | 10% | 8% | 8% | 8% | 8% | 10% | 10% |
| South | 4% | 4% | 4% | 6% | 5% | 5% | 5% | 5% |

* 1. As already highlighted, the corporate loan is also more-or-less aligned to the MFI business
1. Gruh business – The business is being led by the existing Gruh management with no interference by the Bandhan management.“*I know microfinance, I am doing microfinance. I am not knowing housing, I have been taken that as a total system and people and their IT, they will decide where is the best, how it can be driven, how can we grow, and how much they can grow, everything they are independently deciding, I only make this portfolio as my book, I only provide my liability support to them, they will not suffer any of the funding point of view*”

While the opportunity is large, there are certain headwinds that the affordable housing business is facing with regards to asset quality, people’s ability/willingness to repay. From the table below, it can be seen that even after the transaction, the ratios, mix, metrics have more or remained the same or have become more conservative. However what is also noteworthy is that the loan book actually shrunk in the last quarter which Bandhan management explained was driven by the bank focussing on merger (which in hindsight has ben a blessing due to the stress that may come upon due to Covid impact)

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| (In Rs. Bn) | FY 17 | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 |
| Customer Segment |
| Salaried |  |  |  |  |  |  |  |  |  |  | 55.1% | 55.9% |
| Self-Employed |  |  |  |  |  |  |  |  |  |  | 44.9% | 44.1% |
| Nature of Loans |
| PSL |  |  |  |  |  |  |  |  |  |  | 83% | 83% |
| LTV |  |  |  |  |  |  |  | 66% | 69% |  | 70% | 67% |
| Types of Loans |
| Housing | 81.2% | 82.2% | 81.9% | 82.4% | 82.6% | 82.6% | 82.5% | 82.9% | 82.7% | 83.1% | 83.7% | 84.0% |
| Mortgage | 11.2% | 13.8% | 14.0% | 13.6% | 10.8% | 12.9% | 12.8% | 12.3% | 10.3% | 10.3% | 10.0% | 9.9% |
| NRP | 3.1% |  |  |  | 2.4% |  |  |  | 1.9% | 1.9% | 1.9% | 1.8% |
| Construction | 4.5% | 4.0% | 4.0% | 4.0% | 4.3% | 4.5% | 4.7% | 4.8% | 5.1% | 4.7% | 4.5% | 4.3% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Avg. Loan |  |  |  | 7.74 | 7.83 | 7.9 | 8.01 | 8.07 | 8.19 | 8.27 | 7.74 | 7.83 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost to income |  | 15.46% | 16.36% | 15.42% | 14.16% | 14.19% | 15.93% | 16.17% | 15.79% | 15.66% |  |  |
|   |  |  |  |  |  |  |  |  |  |  |  |   |
| FOIR |  |  | 33% | 38% | 39% | 38% | 39% | 36% | 38% | 36% | 37% | 36% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan Book (in Rs. Bn.) |  | 136 | 142 | 148 | 155 | 159 | 166 | 168 | 174 | 177 | 192 | 190 |

1. MSME + Small Enterprise Lending: As mentioned earlier, MSME segment is a new segment where Bandhan has tried to create its presence. There is limited information available on the type of customer except for the following:
	1. Avg. ticket size for MSME: 28.7 Lakh
	2. Avg. SEL loan: 1.84 Lakhs with 30% MFI customer migrating to availing SEL loans

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 | HDFC | Kotak | ICICI | Axis | SBI |
| Yield | 16.7% | 15.1% | 15.4% | 14.6% | 15.4% | 15.3% | 15.4% | 15.6% | 15.7% | 14.2% | 14.0% | 10.5% | 9.8% | 8.7% | 8.8% | 7.9% |
| Cost of Funds | 7.0% | 6.7% | 6.8% | 6.2% | 6.5% | 6.3% | 6.3% | 6.1% | 6.6% | 7.2% | 7.2% | 5.2% | 5.3% | 4.7% | 5.1% | 4.8% |
| Spread | 9.7% | 8.4% | 8.6% | 8.4% | 8.9% | 9.0% | 9.1% | 9.5% | 9.1% | 7.0% | 6.8% | 5.3% | 4.5% | 4.1% | 3.7% | 3.0% |
| NIM | 10.8% | 9.3% | 9.6% | 9.3% | 10.3% | 10.2% | 10.5% | 10.7% | 10.5% | 8.2% | 7.9% | 4.2% | 3.9% | 2.9% | 2.9% | 2.5% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Gruh NIM | 4.4% | 4.4% | 4.4% | 4.4% | 4.3% | 4.1% | 3.9% | 4.0% | 3.8% |  |  |  |  |  |  |  |

Bandhan appears to have found a niche segment which it is dominating/serving at scale, and therefore is able to price the loans at attractive spread/NIM and even with the Gruh transaction it can be expected to be maintain superior margins.Concentration Risk:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Bandhan Bank | HDFC Bank | Kotak | ICICI Bank | Axis Bank | SBI Bank |
|  | FY 19 | FY 18 |  |  |  |  |  |
| % of advances to top 20 borrowers | 5.95% | 5.80% | 10.6% | 8.99% | 10.8% | 8.56% | 12.6% |
| % of exposure to top 20 customers | 5.92% | 5.77% | 11.1% | 9.08% |  | 12.35% | 12.8% |
| Top four NPA A/C | 402.64 | 0.40 | 730 | 638 |  | 4513 | 30314 |
| Top 4 NPA % Advances | 1.02% | 0.00% | 0.09% | 0.31% |  | 0.91% | 1.39% |

Comparison of nature of loan book across banks (just for reference)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| (in Rs. Bn.) | Bandhan | HDFC | Kotak | Axis | ICICI |
| Product AUM | Q3FY 20 | FY 19 | FY 18 | FY 19 | FY 19 | FY 19 | FY 19 |
| Micro | 401.00 | 386.15 | 276.50 | 3,593.6 | 601.50 | 2458 | 1744 |
| Retail (ex-Mortgage) | 7.96 | 18.83 | 14.09 |
| Agri |  | - | - |  | 269.90 |  |  |
| Auto |  | - | - | 913.8 |  | 270.38 | 556 |
| Personal Loans |  | - | - | 938.0 | 331.60 | 294.96 | 310 |
| Kisan Gold Card / Rural Loans |  | - | - | 403.6 |  | 344.12 | 499 |
| Credit Cards |  | - | - | 466.3 |  | 122.9 | 123 |
| Others |  | - | - | 227.7 |  |  |  |
| Two Wheelers |  | - | - | 112.7 |  |  |  |
| Gold Loans |  | - | - | 58.3 |  |  |  |
| Loans against securities |  | - | - | 35.9 |  |  |  |
| Business Banking - Retail |  |  |  |  |  | 73.74 | 188 |
| Other Retail |  | - | - | 437.0 |  | 196.64 | 68 |
| Mortgage + LAP | 190.78 | - | - | 513.7 | 407.22 | 1155.26 | 1782 |
| SME + SEL | 23.32 | 18.41 | 17.86 | 1,804.4 | 379.00 | 655 | 306 |
| CV/CE |  | - | - | 554.2 | 197.00 |  |  |
| Business Banking |  | - | - | 1,250 | 182.00 |  |  |
| Corporate | 30.94 | 24.38 | 12.91 |  | 618.61 | 1834 | 1401 |
| Corporate |  | - | - |  | 507.80 |  |  |
| NBFC-MFI | 23.87 | 19.87 | 12.26 |  |  | 787 |  |
| NBFC-Other | 7.07 | 4.51 | 0.65 |  | 111 |  | 431 |
| Other Wholesale Banking |  | - | - | 2,282.5 | 50.00 |  |  |
| TOTAL | 654 | 447.77 | 321.36 | 7,680.6 | 2,056.3 | 6,102.2 | 5,233.0 |

 |
| **Credit Quality – NPAs**Provisioning norms: 🗹 Conservative 🞎 AggressiveDivergence post RBI review: 🗹 No 🞎 YesManagement experience: 🗹 Across Cycles 🞎 Recently appointedManagement Alignment: 🗹 Aligned to shareholder (high % of shares owned) 🞎 Can’t sayProvision Coverage Ratio: 🗹 >70% 🞎 70%-60% 🞎 60%-50% 🞎 <50% |
| The bank appears to be conservative with regards to the provisioning methodology and for the microloans, follows the below mentioned provisioning:* Standard: 1% vs RBI requirement of 0.25%
* Sub-standard: 25% in line with max limit defined by RBI
* Doubtful and Loss Asset: 100% in line with max limit defined by RBI

Non MFI loan book provisioning is maintained at the RBI prescribed levels, therefore reflecting conservativeness.Gruh loan book, saw an increase in GNPA due to change in way GNPA are computed/defined in an NBFC vs Bank, the management mentioned that all the changes due to the above have been accounted for in Q3, and no increase in GNPA can be expected due to the regulation. Therefore, on an on-going BAU GNPA would be 0.5% but may spike due to Covid crisis.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|   | Q1 FY 18 | Q2 FY 18 | Q3 FY 18 | Q4 FY 18 | Q1 FY 19 | Q2 FY 19 | Q3 FY 19 | Q4 FY 19 | Q1 FY 20 | Q2 FY 20 | Q3 FY 20 | HDFC | Kotak | ICICI | Axis | SBI |
| Segmental GNPA |
| Micro |  |  |  |  |  |  |  |  |  | 0.42% | 0.47% |  |  |  |  |  |
| Other |  |  |  |  |  |  |  |  |  | 1% | 0.97% |  |  |  |  |  |
| GRUH | 0.64% | 0.67% | 0.73% | 0.45% |  | 0.88% | 0.87% | 0.66% | 0.95% | 0.34% | 0.49% |  |  |  |  |  |
|   |  |  |  |  |  |  |  |  |  |  |   |  |  |  |  |  |
| GNPA | 0.93% | 1.40% | 1.70% | 1.25% | 1.26% | 1.29% | 2.41% | 2.04% | 2.02% | 1.76% | 1.93% | 1.4% | 2.1% | 6.7% | 5.3% |  |
| NNPA | 0.56% | 0.80% | 0.80% | 0.80% | 0.64% | 0.69% | 0.70% | 0.58% | 0.56% | 0.56% | 0.81% | .39% | 0.75% | 2.29% | 2.20% | 3.01% |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Credit Cost | 1.37% | 1.60% | 1.60% | 1.51% | 0.78% | 1.08% | 5.70% | 1.51% | 1.29% | 0.95% | 1.85% |  |  |  |  |  |
| NPA | 1.01% | 1.30% | 1.20% | 0.70% | 0.66% | 0.91% | 5.50% | 0.98% | 1.06% | 0.98% | 1.32% |  |  |  |  |  |
| Standard | 0.36% | 0.30% | 0.40% | 0.81% | 0.12% | 0.17% | 0.20% | 0.53% | 0.23% | -0.03% | 0.53% |  |  |  |  |  |
| Extra Provisioning |  |  |  |  |  |  | ILFS 300 Cr. |  |  |  | Assam Unrest 200 Cr. |  |  |  |  |  |
| PCR |  |  |  | 54% |  |  |  | 72% |  |  |  | 71% | 65.4% | 80.7% | 77% | 78% |

As NPA provisioning involves a lot of subjectiveness, I need some better understanding on how it is all computed or how correctly it reflects the reality. However I am drawing comfort through the following data points:1. NPA provisioning maintained at the highest level as defined by the RBI
2. Standard provisioning higher at 1%, providing a buffer for future delinquencies
3. No divergence reported post RBI inspection of the annual records
4. Whole book is retail focused with smaller duration loans, so loans would move to NPA quickly (within one year as 75% of the book is less than 1 year tenor) and there is less risk that write-off would occur far into the future
5. Bank’s policy of one customer one loan, which avoid the situation of evergreening
6. Management has been in this business across multiple cycles so it can be expected that they know sustaining business through accounting trickery on provisioning will not be sustainable
7. Management has a large shareholding in the bank >60% so interest should be aligned with the shareholders

On an on-going basis, there is an increasing risk of incidences of one-off events which can affect the portfolio quality (i.e. 2008 global financial crisis, 2010 Andhra Crisis, 2012 Indian economy slowdown 2016 Demonetization 2017 GST 2019 Floods, CAA 2020 Covid) which implies that the bottom of pyramid customers have been facing tough economic situations and are generally stressed. In view of this the following risks are possible:1. Bandhan has been window-dressing its book (less probability due to no divergence reported post RBI audit)
2. Going ahead risk may increase, and therefore customer selection has to be restricted or
 |
| **Other Income**Nature: 🗹 Business operations led 🞎 Treasury/one-off led 🗹 Processing Fee 🞎 Can’t be explainedPricing Power: 🗹 Yes 🞎 No |
|

|  |  |  |  |
| --- | --- | --- | --- |
| In Rs. Cr. | Transaction Value | Commission | Comment |
| MF Distribution | 132 | 1.69 |  |
| LI Distribution | 470 | 22.5 | Linked to MFI loans disbursed, therefore sustainable |
| GI Distribution | 2.13 | 0.24 |  |
| HI Distribution | 51 | 8.04 |  |
| PoS | 4630 | 4 | Computed at 0.1% typical for acquiring business, assuming debit card spends |
| PSLC |  | 308 | MFI and Housing loans ~85% is eligible for PSL, and therefore PSLC income is sustainable |
| Loan Processing Fee | 52211 | 522 | Assumed at 1% of disbursements (typical for MFI loans), for others not accounted for |
| **Total** |  | **700** |  |
| **Total Other Income** |  | **1063** |  |

A large part of the other income is driven directly with the operations of the business and therefore seems sustainable in nature. The biggest differentiator and driver of the fee income that other banks don’t enjoy is the PSLC income that the bank is able to extract/realize and will continue to be realized on an on-going basis as RBI is focused on driving financial inclusion at the last mile, and other banks seem reluctant to reach-out to and even if some bank do make the efforts to set-up the infra, not all banks would be able to meet PSL requirements, and therefore Bandhan will be able to enjoy superior other fees.The key metric therefore to track is the amount of loan disbursed, which will drive the biggest component of PSLC and LI commission income. |
| **ALM**Tenor of loans: 🗹 Short Term 🞎 Medium Term 🗹 Long TermTenor of liabilities: 🗹 Short Term 🗹 Medium Term 🞎 Long TermALM Situation: 🗹 Lend Short Borrow Long 🞎 Lend Long Borrow Short 🞎 In-between |
| Advances: Bandhan’s ex-Gruh loan book tenor (as of Q3 FY19)

|  |  |  |
| --- | --- | --- |
| <1 Year | * 1. Year
 | > 3 Year |
| 75% | 24% | 1% |

Gruh’s loan book tenor (as of Q3 FY19)

|  |  |  |
| --- | --- | --- |
| <1 Year | * 1. Year
 | > 3 Year |
| 6% | 11% | 83% |

It can be assumed that the nature of loan book tenor would have seen a dramatic shift as the nature of underlying business is the same, and the management hasn’t mentioned anything about changing its strategy. Therefore in a pre-Gruh era, Bandhan’s ALM would have been well managed due to availability of CASA deposits which while being withdrawable on demand is also consistently available, and the TDs are providing support for the longer term loans (which anyways was very limited in scale). The same can also be seen from the ALM profile as provided for FY 19.Bandhan ALM profile

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| In Rs. Cr. | 1 Day | 2-7 Days | 8-14 Days | 15-28 Days | 29 Day – 3 Month | 3-6 Months | 6 Month – 1 Year | 1 – 3 Year | 3 – 5 Years | >5 Year | Total |
| FY 18 |
| Asset | 645 | 768 | 700 | 1510 | 4855 | 7214 | 8740 | 7592 | 331 | 5734 | 38089 |
| Liability | 99 | 988 | 1076 | 560 | 5747 | 2640 | 7671 | 14691 | 548 | 134 | 34154 |
| Delta | 546 | -220 | -376 | 950 | -892 | 4574 | 1069 | -7099 | -217 | 5600 | 3935 |
| FY 19 |
| Asset | 219 | 1038 | 974 | 2145 | 7985 | 9694 | 13722 | 6558 | 816 | 6560 | 49712 |
| Liability | 161 | 1044 | 1326 | 357 | 2175 | 2326 | 9730 | 24429 | 1454 | 230 | 43232 |
| Delta | 58 | -6 | -351 | 1788 | 5810 | 7368 | 3992 | -17871 | -638 | 6330 | 6480 |

GRUH ALM Profile

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| In Rs. Cr. | 1-30 days | 1-2 month | 2-3 month | 3-6 month | 6-12 month | 1-3 Year | 3-5 Year | 5-7 Year | 7-10 Year | >10 Year |
| Assets | 80 | 230 | 82 | 261 | 504 | 1923 | 1598 | 1719 | 2630 | 8723 |
| Liability | 100 | 254 | 713 | 236 | 5838 | 3739 | 3545 | 700 | 650 | 605 |
| Delta | -20 | -24 | -631 | 25 | -5334 | -1816 | -1947 | 1019 | 1980 | 8118 |

Even before Gruh’s acquisition, the ALM was mismatched in the 1-3 year bucket, and with Gruh transaction the situation would worsen in the 1-5 year bucket, therefore the business in the shorter duration will not have any issues, as they lend shorter and borrow longer, however in an unexpected freeze of credit market would there be a problem (which is unlikely). The only challenge that Bandhan would face is that as a bank, Bandhan will not be able to issue NCDs like Gruh did and therefore has to mobilize these liabilities through longer term FDs, issuing sub-ordinate debt and Certificate of Deposits which would lead to higher cost of funds, as also reflected in the last few quarter for the current FY. |
| **Technology**Usage of technology: 🗹 Branch/Banking Outlets 🗹 Field Force 🞎 CustomerTechnology Focus: 🗹 Operation Efficiency 🞎 Loan Sourcing 🗹 Customer Experience ? Self-Service |
| Bandhan when converting to a bank, chose to use FIS as the core-banking solution which is one of the leading core-banking systems in India apart from Finacle and Bancs. Bandhan has outsourced all the IT developments to FIS which while in the short run is better, takes away the benefits that owning one’s technology provides (something what internationally banks are doing by increasing the share of business given to captives vs outsourced vendors).Apart from using CBS which is regulatory requirement laid down by the RBI for universal banks, Bandhan has used technology at scale at the field level wherein the loan officers are provided with a biometric enabled micro-ATM which can help them process transactions quickly in real-time as well as provide visibility to the management on the performance of business, and thus increasing the operational efficiency as well as transparency. This usage of technology has enabled Bandhan to perform its back-office operations through regional and central processing centres one at Indore and other at Kolkatta, which appears on the lower side compared to other banks which have a large legacy back office infrastructure.However, most of the technology initiatives are focused towards optimizing the operations and not on increasing self-service and digital sourcing of business (like HDFC, ICICI or Kotak does for both asset and liability business), this may be due to the nature of customers itself not being tech savvy (also partially admitted by the management) and therefore the business can be expected to be tightly driven by branch expansion rather than digital channel expansion driven. |
| **POSSIBLE RED FLAGS** |
| 1. Growth has been driven by increasing avg. O/S per customer, which quickly unravel incase of economic/natural pressure (like political unrest, Covid, floods etc.) and lead to high NPAs
2. FY 19 Capital Adequacy is mentioned as 29.2% which would be computed using the risk weighted approach prescribed by RBI. As Bandhan has the hypothecation clause in the loan contracts, it can be assumed that Bandhan is taking them as secured loans (as reflected by RBI reporting of 95% secured loans in FY 19), which makes computation of Risk Weighted Asset for the micro loans at 100% weightage vs 125% for unsecured loans. Therefore, CRAR might be over-estimated, as recovery might be difficult in reality OR there would coercive practices adopted to do the recoveries
3. SA balance per Debit Card, seems very high for a bank which is targeting the middle class or affordable class customers; other explanation is that they don’t issue debit cards to customers (seems unlikely unless they are targeting Jan-Dhan customers) and there doesn’t seems to be any visible strategy that Bandhan has followed to get to such a large deposit base.
 |

1. Assuming correct computation (refer RED FLAG) [↑](#footnote-ref-1)
2. Such a high SA per debit card seems a bit off for Bandhan, given MFI customers comprise 6% of deposits; removing their deposits contribution and assuming no debit card was issued to them, then also the avg. SA per DC comes at 38,092, which appears very high for a bank which may not be the primary account for customers, and neither targeting the upper and higher class [↑](#footnote-ref-2)