June 7, 2018

Rating matrix		
Rating	:	Buy
Target	:	₹ 600
Target Period	:	12 months
Potential Upside	:	22%

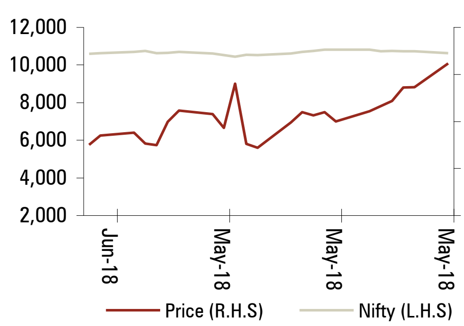
Fundamental summary				(₹ crore)
	FY17	FY18E	FY19E	FY20E
NII	2403	3032	4348	5790
PPP	1793	2430	3567	4656
PAT	1112	1346	2018	2612

Valuation summary				
(x)	FY17	FY18	FY19E	FY20E
P/E	48.3	43.4	29.0	22.4
Target P/E	59.1	53.2	35.5	27.4
P/ABV	12.2	6.3	5.3	4.4
Target P/ABV	15.0	7.8	6.6	5.4
P/BV	12.1	6.2	5.2	4.3
RoE (%)	28.6	19.5	19.6	21.1
RoA (%)	4.4	3.6	4.0	4.0

Stock data	
Particulars	Values
Market Capitalisation	₹ 58232 crore
Networth	₹ 9382 crore
52 week H/L (₹)	540 / 455
Equity Capital	₹ 1193 crore
Face Value (₹)	10.0
DII Holding (%)	1.9
FII Holding (%)	10.1

Comparative Return Matrix (%)				
	1M	3M	6M	12M
Bandhan	-8.5	NA	NA	NA
Ujjivan	-4.2	4.3	1.3	29.1
Equitas	5.0	9.0	10.0	5.5

Price Movement * listed in March 2018



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Bandhan Bank (BANBAN)

₹ 490

Best yields with lower cost of funds; unique model

Bandhan Bank is a unique business model of high yielding micro finance loan portfolio (94% priority sector fulfilment) and low cost deposit franchise with 34.3% CASA offered in the ambit of a commercial bank. It was the only MFI to receive a universal banking licence from the RBI in 2014 led by Founder, MD and CEO, Chandra Shekhar Ghosh, who has 37 years of experience in the Indian microfinance industry.

Bandhan Bank, with 13-14% market share, operates 936 branches and 2,764 dedicated doorstep services centres servicing ~1.3 crore customers in 33 states. East and northeast (West Bengal, Bihar, Assam) are its stronghold. FY18 AUM was at ₹ 32340 crore a PAT at ₹ 1346 crore.

Investment Rationale

Consistent track record of quality growth, banking adds positive leg

Bandhan MFI was one of the few institutions to sail through the AP crisis (2011), demonetisation (2016), farm loan waivers, etc. It has demonstrated stellar growth at ~90% CAGR in those 10 years. Even in the last five years, advances grew at 51% CAGR. In bank, AUM has grown from ₹ 15,578.4 crore as of FY16 to ₹ 32,340 crore as of FY18 while customer base has increased to ~1.3 crore. Micro credit forms 86% of loan book while retail, SME together are still small. Asset quality is strong at 1.2% GNPA ratio. We expect 38% CAGR in loans to ₹ 61546 crore by FY20E.

Strong deposit franchisee in short span, high CASA offers low CoF

Bandhan Bank has focused on building a strong deposit base and has grown from zero as of August 23, 2015, to ₹ 33,869 crore in FY18. Current and savings account deposit (CASA) was at ₹ 11,617 crore, constituting 34.3% of deposits. CASA provides stable low-cost funding with CoF now at 6.7%. We expect deposits growth at ~31% with CASA ratio ~36%. Only 6% of deposits come from MFI clients. Majority of deposits come from bank branch customers while 80% of the same is retail.

Strong NIMs, low cost-to-income lead to above par return ratios, BUY

Net interest margin (NIM) was at 9.8% for FY18. With low cost funds, we expect NIM to sustain at ~9% even as the bank starts building non-micro loans. Along with higher NIM, low operating cost at ~35% C/I ratio remains its key differentiator, high RoA driver. Its opex to AUM ratio was at 4% for FY18. We expect high RoA of 3.5-4%, RoE >20% to sustain. With almost double NIM, RoA vs. HDFC Bank & lower C/I ratio, with no legacy corporate portfolio pains, we believe Bandhan Bank will command higher premium to HDFC Bank. At CMP of ₹ 490, the stock is available at 4.4x FY20E ABV of ₹ 111. On P/E basis, it is available at 22.4x FY20E earnings of ₹ 22 EPS. Valuing the bank at 5.4x FY20E ABV, we arrive at a target price of ₹ 600. We initiate coverage with a **BUY** recommendation.

Exhibit 1: Financial Summary

Key Financials	FY17	FY18	FY19E	FY20E
Net Profit (₹ crore)	1,112.0	1,345.6	2,018.2	2,612.2
EPS (₹)	10.2	11.3	16.9	21.9
ABV (₹)	40.0	77.2	91.6	110.8
P/E (x)*	48.3	43.4	29.0	22.4
P/ABV (x)*	12.2	6.3	5.3	4.4
RoE (%)*	28.6	19.5	19.6	21.1
ROA (%)*	4.4	3.6	4.0	4.0

** Dip in multiple and return ratios is due to capital raising (IPO) in FY18*

Source: RHP, Company, ICICI Direct Research

Shareholding pattern (FY18)

Shareholder	Holding (%)
Promoter	82.3
Institutional Investors	11.4
Others	6.3

Source: BSE

Top Shareholders	(%)
BFHL (Parent company)	82.30
CALADIUM INVESTMENT PTE LTD	4.58
IFC	2.94
IFC FIG	1.59
AXIS ASSET MANAGEMENT CO LTD	0.99
SBI FUNDS MANAGEMENT	0.43
SIDBI	0.29
MGMT	0.29
KOTAK MAHINDRA	0.13
GHOSH CHANDRA SHEKHA	0.12

Source: Bloomberg

Company Background

Bandhan started as Bandhan Konnagar in 2001 as a non-governmental organisation (NGO) providing microfinance services to socially and economically disadvantaged women in rural West Bengal. Bandhan Financial Services (BFSL) started its microfinance business in 2006. The NGO transferred its microfinance business to BFSL in 2009. Thus, the entire microfinance business was undertaken by BFSL from 2009.

Exhibit 2: Bandhan's performance as NBFC until FY15

	FY12	FY13	FY14	FY15
NII (₹ crore)	402	358	535	750
PAT (₹ crore)	226	218	294	430
Loans (₹ crore)	3103	4097	5801	8309
GNPA %	0.0	0.0	0.7	0.6
RoE %	34.9	27.3	28.3	31.1
RoA %	5.4	4.5	4.8	5.0

Source: Company, ICICI Direct Research

On April 9, 2014, RBI granted an in-principle approval to BFSL to set up a scheduled commercial bank in the private sector. Upon receipt of the in-principle approval, BFSL and Bandhan Bank entered into a business transfer agreement to transfer all of BFSL's existing microfinance business, including all assets, liabilities, accumulated profits and entire infrastructure, along with a wide consumer base to the bank. By the time BFSL transferred its microfinance business to the bank, it was India's largest microfinance company with AUM of ~₹ 8309 crore and ~70 lakh customers. With historical strength in the microfinance segment, Bandhan Bank, which began operations on August 23, 2015, is now a commercial bank focused on serving underbanked and underpenetrated markets in India.

As can be seen in the above exhibit, Bandhan's performance before becoming a bank has been superior on all fronts. Loans have increased at 39% CAGR while earnings have risen at 24% CAGR to ₹ 430 crore in FY12-15. Asset quality remained stable while return ratios were one of the best in the industry.

However, post becoming a bank, the superior performance has continued. It started operations with 501 branches in 24 states across India as of August 23, 2015. As of FY18, the number of ATMs and dedicated doorstep services centres (DSCs) was at 430 and 2764 vs. 50 and 2022 as of August 23, 2015, respectively. The bank's branches have expanded to 936 servicing ~1.3 crore (1.06 crore micro and 25 lakh general banking customers) customers in 33 states.

The advances book as on FY18 was at ₹ 29713 crore. The bulk of the book i.e. ~84% is related to micro loans while the balance is towards SME and other retail loans segment. Bandhan Bank has the highest MFI portfolio within banks. It is 3x its closest competitor SBI's MFI portfolio at ~₹ 6130 crore. The management has indicated that, going ahead, the major focus will continue to be on micro finance. We expect total AUM to witness a CAGR of 38% in FY18-20E to ₹ 61546 crore.

Exhibit 3: Break up (segment wise) of advances (net) (₹crore)

	FY16	FY17	FY18
Gross advances (AUM)	15,578	23,543	32,340
Net advances (O/s Loan Book)	**12,438**	**16,839**	**29,713**
Micro loans	12,278	14,684	25,024
Small enterprise loans	-	1,050	1,639
SME loans	100	710	1,641
Other retail loans	60	390	1,409

Source: RHP, ICICI Direct Research

In terms of area of operations of the bank, east and northeast India (especially West Bengal, Bihar, Assam) are strongholds for the bank with a substantial presence in terms of branches, DSCs, proportion of deposits and advances. As of December 2017, ~65% of branches are in eastern and north-eastern India. In terms of advances, ~80.8% of loans comprises the east and north-eastern regions. However, the bank is focusing on developing a pan-India network to achieve geographical diversification. Accordingly, the bank has increased its footprint to 33 states and union territories from 24 states and union territories at the commencement of banking operations.

Exhibit 4: Geographical break up of gross advances (Q3FY18) (₹crore)

Region	Loan Portfolio
Central	2,123
Eastern	14,186
Northern	880
Northeastern	5,522
Southern	351
Western	1,302
Gross Advances	24,364

Source: RHP, ICICI Direct Research

On the deposit front, the book has grown from zero as of August 23, 2015 to ₹ 33869 crore as on FY18, with CASA ratio at ~34.3% and retail-to-deposit ratio at 85.07%. For FY18, net interest income (NII) amounted to ₹ 3032 crore vs. ₹ 2404 crore in FY17. The net interest margin (NIM) was at 9.7% for FY18 compared to 10.4% in FY17. We expect deposit growth to remain healthy ahead at 31% CAGR in FY18-20E to ₹ 58391 crore, with CASA ratio at ~35.7%. With robust growth in AUM at 38% CAGR in FY18-20E and healthy margin (calculated) at ~9.1% in FY20E, NII growth is seen at 38% CAGR to ₹ 5790 crore.

The bank has a healthy capital adequacy ratio (CAR) of 32.7% as on FY18 vs. minimum regulatory requirement of 13%. Tier I ratio was at ~31.5%. Return on equity (RoE) was at 19.5% while RoAs were ~3.6% in FY18. We expect RoA to inch up to ~4.0% in FY20E while RoE is seen improving to ~21% in FY20E.

Exhibit 5: Bandhan's Product Details

Micro loans	Microloans business provides women with the opportunity to start businesses and invest in income generating activities by having convenient access to funds. In addition, it also offer microloans to pay for children's education as well as medical emergencies All microloans are group-based individual loans, which are loans provided to individuals who form a group of 30 members The bank has several micro loan options with loan tenures up to two years with a maximum loan amount of ₹ 150,000 Collections for micro loans happen on a weekly basis
Housing loans	The bank provides housing loans with a maximum tenure of 20 years for the acquisition, construction and extension of residential properties The maximum loan-to-value ratio for such housing loans ranges from 75% to 90% as per guidelines from the RBI It provide loans from ₹ 300,000 to ₹ 20,000,000, at rates from 9.50% to 14.0%
Two wheeler loans	The bank offer loans for the purchase of two wheelers with repayment for up to three years, which can be up to 85% of the on road price of two-wheeler The minimum and maximum loan amounts are ₹ 10,000 and ₹ 150,000, respectively, at rates of 15-17.0%
Personal loans	The bank offer personal loans at fixed rates to individuals for amounts of ₹ 100,000 to ₹ 500,000 and tenures of 12 to 36 months at rates of 14-18% Personal loans can be used for a wide variety of purposes including buying a dream home or bike, planning for vacations, weddings and most personal needs
LAP	It extended loans against property for self-occupied residential and commercial (shops and offices) properties. These loans provide working capital without liquidating fixed assets The maximum loan tenure and loan-to-value ratio are determined by the current age and profile of borrower, with a maximum tenure of 15 years and loan-to-value ratio of up to 60% of the market value of the property They provide loans from ₹ 100,000 to ₹ 20,000,000 at rates of 12.0% to 14.5%
Gold loans	The bank also offer loans against gold ornaments (i.e. jewellery) to specific customer segments. Such loans are offered with monthly interest payments and principal due at maturity These loans also have a margin requirement in the event of a reduction in value of the gold collateral
SME Loans	SME loans are designed to help entrepreneurs start or scale up their small and medium sized enterprises by helping create income generating assets and enhancing liquidity These loans include business loans, commercial vehicle loans, term loans, equipment loans and working capital loans Term loans in this category are offered at a rate of 11.0% to 13.5%
Small Enterprise Loans	Small enterprise loans are collateral-free income generating activities loans in the form of working capital or assets creation for business or short-term business requirements The bank classifies loans to businesses up to ₹ 1,000,000 as small enterprise loans whereas it classifies loans in excess of ₹ 1,000,000 as SME loans Small enterprise loans are composite loans in the form of demand/term loans for manufacturing, trading and service. Small enterprise loans may vary from ₹ 100,000 to ₹ 1,000,000 and have loan tenures from one to three years with a processing fee up to 2% and an interest rate of 16%

Source: Company, ICICI Direct Research

Micro finance – Huge untapped market at bottom of pyramid!

In the Indian context, micro finance began as an alternative means to provide finance to the unserved masses at the lower strata of the socioeconomic pyramid. However, micro finance has turned out to be an effective means to improve the standard of living of the deprived section of society. Over the years, the sector has witnessed many highs and lows with exponential growth in the beginning. It faced a major crisis thereafter, which almost brought the sector to a standstill. With regulatory support and evolution in the business model, the sector has made a gradual comeback. Though it has made significant progress, the journey is still far from over. In India, the opportunity in the micro finance sector remains huge. As per our estimates, ~10 crore households with credit requirement of ~₹ 5.5 lakh crore, are yet to be included in the financial network. This provides the micro finance sector with immense opportunity for growth ahead.

Banks constitute major chunk of microfinance industry; southern region has bulk of share

The micro finance industry (MFI) in India has multiple players with varied organisational structures. This includes banks, small finance banks (SFBs), NBFC-MFIs (specifically constituted to lend to MFI sector), other NBFCs, and non-profit organisations. Total micro finance advances in India were at ~₹ 2 lakh crore as on December 2017 (refer exhibit below). Women borrowers comprised 96% of borrowers.

Among constituents, banks (including direct, indirect bank lending through business correspondents and to self help groups) account for a major chunk at ~57% share of overall micro finance credit in India.

Top micro finance portfolio (₹ crore)

FY17	Group	/IFI loan (₹ crore)
Bandhan Bank	**Private Sector Bank**	**21,380**
Janalakshmi Financial	Small Finance Bank	12,550
Bharat Financial	NBFC – MFIs	9,150
SKDRDP	NBFC – MFIs	6,399
Ujjivan	Small Finance Bank	6,220
State Bank of India	Public Sector Bank	6,130
Andhra Bank	Public Sector Bank	4,930
Satin Credit Care	NBFC – MFIs	3,617
Equitas	Small Finance Bank	3,290
Canara Bank	Public Sector Bank	3,270

urce: RHP, ICICI Direct Research

Exhibit 6: Break-up of total MFI loans in terms of different players

Partculars (₹ Crore)	FY16	FY17	Dec'2017	Proportion(%)
NBFC MFI	35565	44519	39916	22.0
NBFCs	4247	6026	9291	5.1
SFB (Small Finance Banks)	13065	14477	27506	15.1
Banks (includes Bandhan Bank)	30861	40993	45649	25.1
Non Profit MFIs	978	901	981	0.5
MFI loans (excluding SHGs)	**94129**	**118796**	**137048**	
SHGs (Bank lending to Self Help Groups)	57120	61848	64940	32.2
Total MFI loans in the country	**151249**	**180644**	**201988**	**100**

Source: MFIN, The Bharat Micro Finance Report, ICICI Direct Research

As per MFIN report on NBFC-MFIs, the purposes for which MFI loans are taken include agriculture and allied activities, trade & services, manufacturing/production and for personal household purposes like education, medical, etc, as described in the below exhibit.

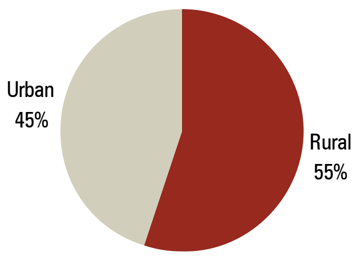
Exhibit 7: MFI loans largely used for agriculture purposes followed trade & services

Agriculture & Allied activities	**49%**
Agriculture	49%
Non Agriculture	**47%**
Trade & Services	39%
Manufacturing/ Production	8%
Household finance	**4%**
Education	2%
Medical	0%
Housing / Home improvement	1%
Other houseold finance	1%

Source: MFIN report, ICICI Direct Research

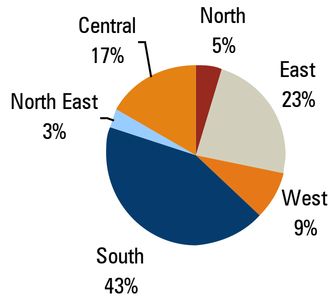
In terms of geography, most MFI loans are in rural areas at ~55%. In terms of regions, south dominates the overall loan portfolio outstanding of MFIs with 43% followed by East with 23%. Central and West have a share of 17% and 9%, respectively. North and North East have least portfolio share of 5% and 3%, respectively.

Exhibit 8: MFI loans mainly in rural areas



Source: MFIN report; ICICI Direct Research

Exhibit 9: Southern & Eastern region has bulk of MFI loans



Source: MFIN Report, ICICI Direct Research

Top 10 MFIs contribute ~70% of total NBFC MFI portfolio. In terms of states, top 10 states account for 91% of the NBFC MFI portfolio as on FY17. MFIs currently operate in 30 states, four union territories and 563 districts in India. Women borrowers accounted for 96% of borrowers.

Exhibit 10: Top 10 NBFC-MFIs (excluding banks, SHGs, SFBs)

MFIs	Loans (₹ Crore)	Major States
BFIL	9150	Odisha, Bihar, WB, Karnataka
SKDRDP	6399	
Satin Credit Care	3617	UP, MP, Bihar, Punjab
Grameen Koota	3075	Karnataka
Muthoot Microfin	1972	
Asirvad Micro Finance	1793	
Cashpor Micro Credit	1330	
Disha Microfin Ltd	1314	
Spandana Sphoorty	1297	
Annapurna Microfinance	1239	
Total	**31186**	
% of total NBFC-MFI book	70.1	

Source: MFIN report ICICI Direct Research

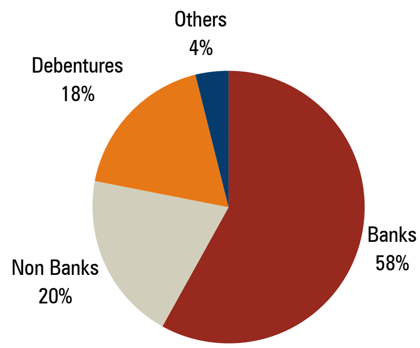
Exhibit 11: Top 10 states with MFI loans (excluding banks, SHGs, SFBs)

States	Loans (₹ Crore)
Karnataka	11952
Tamil Nadu	5164
Uttar Pradesh	4207
Odisha	3564
Bihar	3541
Maharashtra	3457
West Bengal	3140
Madhya Pradesh	2711
Kerala	1668
Assam	1186
Total	**40590**
% of total NBFC-MFI book	91.2

Source: MFIN report; ICICI Direct Research

The outstanding borrowings of NBFC MFIs is ~₹ 37000 crore as on FY17. Bulk of it i.e. ~58% is from banks (refer exhibit below). Hence, the industry largely has higher borrowing costs and, thereby, higher lending rates to the sector. Bandhan Bank now has an advantage of access to low cost deposits. Hence, it is able to pass on lower cost of funds in the form of lower lending rates compared to peers in the micro finance industry.

Exhibit 12: Composition of borrowings of NBFC-MFIs – Banks remain major source of funding



Source: MFIN report, ICICI Direct Research

As can be seen in the below table, states like Uttar Pradesh, Maharashtra, Haryana, Madhya Pradesh and Punjab have higher portfolio at risk. This is due to the fact that most of these states have witnessed widespread farm distress owing to their respective governments announcing farm loan waivers. It has been observed that collection efficiency of MFI loans disbursed post demonetisation has returned to 99.8%. This had fallen to dismal levels during the demonetisation quarter.

Exhibit 13: State wise portfolio at risk (PAR) as on December 2017 (excl banks, SFB, etc)

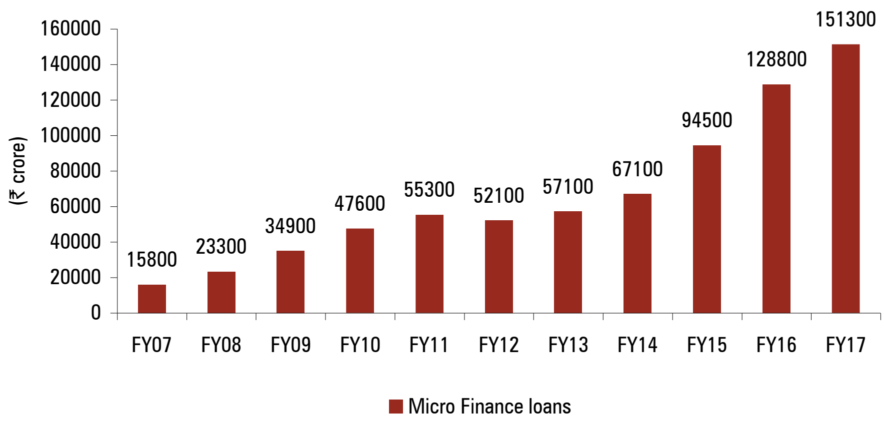
States	PAR>30	PAR>90	PAR>180
Karnataka	4.2	3.6	2.8
Odisha	0.73	0.54	0.34
UP	14.1	10.1	7.2
Maharashtra	14.1	12.6	10.3
Bihar	1.2	0.8	0.5
Tamil Nadu	1.9	1.3	0.9
Madhya Pradesh	8.7	6.6	4.1
West Bengal	2.7	2.2	1.8
Kerala	2.4	1.6	0.85
Jharkhand	5.4	4.5	3.2
Rajasthan	5.7	10.4	7.95
Punjab	7.2	5.3	4
Chhattisgarh	1.6	1.3	0.9
Haryana	13.8	10.5	7.3
Assam	1.4	1.1	0.7

Source: MFIN report, ICICI Direct Research

The micro finance industry in India has evolved, to a great extent. Initially, India adopted the Self Help Group (SHG) model. This model witnessed scale in the nineties on the back of promotion and support from Nabard. Then, in early 2000s many NGOs were started for lending in the micro finance segment. Bandhan Bank was among such NGOs. This was followed by many small NBFCs entering the micro finance industry, which came to be known as NBFC-MFIs (micro finance institutions).

Around, 2009-10, states like Andhra Pradesh (AP) had built excess exposure to micro loans. The total number of MFI clients in the state exceeded the total number of households in the state then at ~1.7 crore. However, due to several incidents of wrongful recovery practices, the state government came out with hard regulations with respect to MFI practices. This impacted existing players in the state negatively. This, in turn, led them to face huge write-offs. GNPA ratios of the MFI industry increased to >20% in 2011 from 1% levels in 2010. The negative impact on growth & quality lasted till 2014. This is reflected in the lower traction of ~7% CAGR in the industry's loan portfolio in 2011-14. The traction between 2007 and 2011 was 37% CAGR as seen in the below exhibit.

Exhibit 14: Micro finance industry loan growth volatile in past 10 years



Source: MFIN; SA-Dhan Bharat Microfinance reports, ICICI Direct Research ; Data is excluding banks

Post the AP crisis, the RBI came out with proper guidelines for the sector. Further, the RBI granted small finance bank (SFB) licences to 10 applicants in September 2015, of which eight were MFIs. These events strengthened investor confidence in these micro lenders. Thus, began another phase of healthy growth for the micro finance sector.

During 2014-17, the advances of the sector increased at 31% CAGR as seen in the exhibit above. However, owing to demonetisation in November 2016 and farm loan waivers in Uttar Pradesh, Punjab, etc, growth & quality was again impacted for two quarters. However, owing to lower tenure of micro loans (< one year), it has been observed lately that impact of demonetisation has subsided now. This is reflected in the fact that collection efficiency of the sector has again returned to >95% levels as seen before demonetisation.

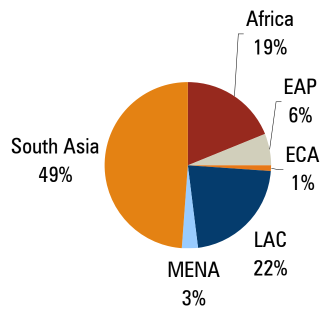
Considering global trends, opportunity for MFI in India remains large

The micro finance industry, through various social and economic linkages of borrowers and their families, is estimated to impact ~1 billion people globally (both in emerging, developed countries). Hence, understanding trends and progress in the sector in international context assumes greater importance. In the international arena, there has been rising disparity among different regions in terms of growth and performance of microfinance sector. Hence, taking a peek at the big picture is imperative.

Over the last few decades, globally, the number of active borrowers has increased from ~70 lakh in 2001 to ~11.7 crore in 2015, registering 22.3% CAGR. Among regions, South Asia has witnessed higher growth in active borrowers owing to large population and relatively lower penetration of financial intermediaries. This has led to a rise in market share of South Asia from ~49% in 2001 to ~57% in 2015 in terms of active borrowers.

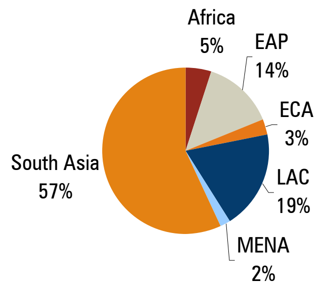
In terms of gross loans, global growth has been higher than addition in borrowers at 32% CAGR in 2001-2015 to ~US$92.4 billion. Region wise comparison reveals a significant decline in market share of Latin America and Caribbean region (LAC) from ~60% in 2001 to ~42% in 2015 while East Asia & Pacific (EAP) and South Asian regions have seen a rise in market share to ~16% and ~20%, respectively. Though the South Asian region leads with regard to number of active borrowers (57% share), market share in terms of gross loans remains lower at 20%. This is owing to low average ticket size, led by low per capita income. In 2015, average ticket size in the South Asian region was at ~US$281 vs. ~US$792 global average.

Exhibit 15: Number of active borrowers - 2001



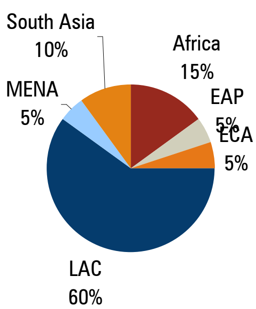
Source: 'Global Outreach & Financial Performance Benchmark Report - 2015, ICICI Direct, Research

Exhibit 16: Number of active borrowers - 2015



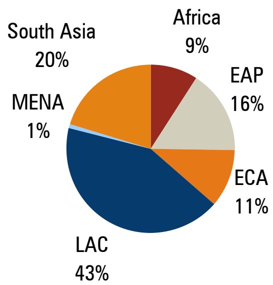
Source: 'Global Outreach & Financial Performance Benchmark Report - 2015, ICICI Direct, Research

Exhibit 17: Gross loans- 2001



Source: 'Global Outreach & Financial Performance Benchmark Report - 2015, ICICI Direct, Research

Exhibit 18: Gross loans- 2015



Source: 'Global Outreach & Financial Performance Benchmark Report - 2015, ICICI Direct, Research

With huge coverage of active borrowers at ~3.8 crore in 2015, representing ~32.6% of global market share, India is ranked ahead of other geographies in terms of active borrowers globally. However, it lags behind in terms of value or outstanding gross loan with ~12.6% market share (~US$12 billion in 2015). The primary reason for lower market share is smaller average ticket size at ~US$306 vs. global average of ~US$792. In addition, India continues to lag in terms of penetration of financial intermediaries at ~12.9% of households compared to ~17.2% in South Asia. Therefore, India remains substantially under penetrated with regard to microfinance lending compared to top markets globally. With increasing outreach and improving ticket size of existing borrowers, growth prospects for micro finance seems bright in India.

Exhibit 19: India has one of the lowest penetration of micro loans compared to other countries

As on 2015	India	Bangladesh	Vietnam	Mexico	Peru	South Asia	World
Operational metrics							
Gross loan (USD million)	11641	5754	7352	4515	9313	18794	92443
Number of active borrowers (000)	38098	23978	7533	6729	4142	66929	116691
Loan per borrower (USD)	306	240	976	671	2248	281	792
Household penetration (%)	12.9	66.2	36.6	23.7	58.6	17.2	
Financial metrics							
Yield on gross loan portfolio (%)	18.0	23.5	8.2	48.8	25.1	20.7	21.0
Operating expense per loan (%)	7.1	10.2	4.0	32.5	13.2	9.1	12.0
RoA (%)	3.4	5.2	0.6	5.1	2.1	4.2	2.4

Source: 'Global Outreach & Financial Performance Benchmark Report - 2015, ICICI Direct Research

Opportunity size for micro finance industry remains large

As can be seen in the below exhibit, despite strong traction in micro finance in the last few years, the opportunity size of the industry in India remains quite large. Currently, total credit requirement by addressable households of ~15 crore is ~₹ 7.5 lakh crore. However, only 4-5 crore households have been served by formal banking channels with micro loans outstanding at ~₹ 2 lakh crore. Thus, credit requirement of households not yet covered by formal lenders is ~₹ 5.5 lakh crore. The number of these household still outside the formal lending system or that are yet untapped is ~10 crore. Thus, a strong trajectory in advances could be expected for the micro finance industry, even from current levels.

Exhibit 20: Opportunity size of micro finance sector

Total Households (HHs)	~24 crore
Addressable HHs	~15 crore
Segment 1	7 crore households in India with some assets (Rs 90/day)
Segment 2 (BPL)	8 crore households in India with no assets (Rs 55/day)
Average credit requirement per HHs	~Rs 50000
Therefore, total credit requirement (₹ crore)	750000
Current O/s Micro loans (₹ crore)	201,988
Current HHs with credit	~4-5 crore
Opportunity size in terms of value (₹ crore)	548,012
Opportunity size in terms of HHs	~10 crore

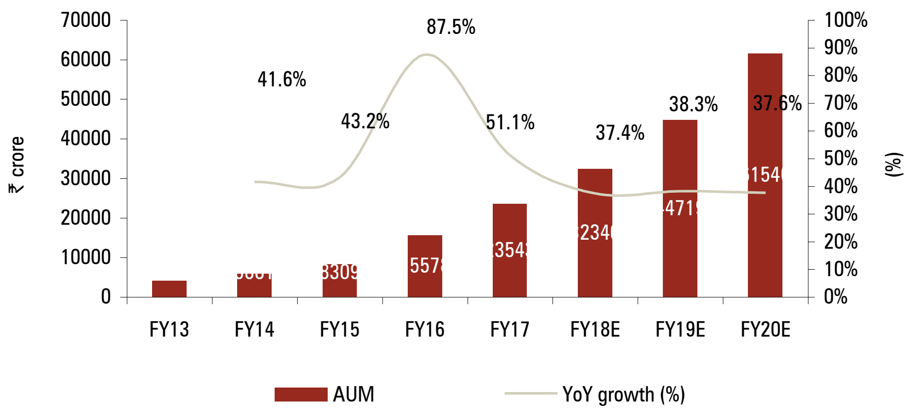
Source: World Bank; SA-Dhan Bharat Microfinance reports, ICICI Direct Research

Investment Rationale

Focus on under-banked regions, new product lines to provide growth

Bandhan Bank is a commercial bank focused on serving under banked and under penetrated markets in India, with its strength in microfinance. Over the years, while the business model has transitioned from an NGO to an NBFC and, thereafter, to a commercial bank, the core focus remained on balance sheet growth. Erstwhile Bandhan's loan book has increased at a robust pace from ₹ 4.6 crore in FY07 to ~₹ 8308 crore in FY15.

Exhibit 21: Robust growth in advances throughout evolution



Source: RHP, ICICI Direct Research

One of the commendable achievements was consistent growth attained despite difficult conditions in India's micro finance industry. For example, while a crisis in Andhra Pradesh beginning in 2010 led to significant pressure on the micro-lending industry and significant write-offs among microfinance institutions, Bandhan's micro loan business thrived at the time, growing from India's fourth largest micro loan portfolio as of March 31, 2010 to India's largest micro loan portfolio as of March 31, 2012.

Since conversion into bank, credit growth pace continued to remain robust at 68.3% CAGR in FY15-17 to ₹ 23543 crore. As of FY18, AUM was at ₹ 32340 crore (up 37.4% YoY). The customer base (micro loans) has increased from 86.9 lakh in March 2016 to 1.06 crore as of FY18.

Bandhan, predominately a micro finance lender, is strong in the segment with a network of 2764 doorstep service centres (DSC) and 1.06 crore micro loan customers. In the initial phase, on getting a banking license, Bandhan Bank inherited micro loans (98.7% in FY16) from the erstwhile NBFC. Post turning into a banking entity, the bank has focused on creating a strong general banking business by adding new products including gold loans, affordable housing finance, vehicle loans and SME loans to the portfolio.

Currently, micro credit forms ~86% of the loan book while retail and SME together are still small due to recent banking operations. Going ahead, though micro loans will continue to remain the major contributor in the loan portfolio, higher growth in the non-micro segment (61.7% CAGR in FY18-20E) is expected to lead to a gradual increase in proportion of non-micro loans from ~16% of loans in FY18 to ~21.9% in FY20E.

Exhibit 22: Break up (segment-wise) of advances (net) (₹crore)

	FY16	FY17	FY18	FY19E	FY20E
Gross advances (AUM)	15,578	23,543	32,340	44,719	61,546
Net advances (O/s Loan Book)	**12,438**	**16,839**	**29,713**	**41,014**	**56,076**
Micro loans	12,278	14,684	25,024	33,347	43,810
Small enterprise loans	-	1,050	1,639	2,622	4,196
SME loans	100	710	1,641	2,790	4,464
Other retail loans	60	390	1,409	2,254	3,607

Source: RHP, ICICI Direct Research

Exhibit 23: DBO based lending model

	Bandhan Bank	Bharat Financial
Number of total borrowers (in lakhs)	106	72.70
Number of active micro borrowers (in lakhs)	78.3	61.88
Number of borrowers in each group	30	21.62
Number of micro groups (in lakhs)	2.61	2.86
Number of DBO (Doorstep banking officer)	19500	15418
Number of groups handled per DBO	13.38	18.56
Number of meeting per day *	2.68	3.71
AUM (MFI) in ₹ crore	27651	12594
Ticket size (active borrowers) in ₹	35314	20352
Ticket size (total borrowers) in ₹	26086	17323

*Source: RHP, ICICI Direct Research; * Assuming 5 days a week*

Exhibit 17: Micro credit forms ~84% of advances

₹ crore	FY17	FY18	FY19E	FY20E
Allied Loans	10,673	132,468	173,802	233,621
Health & Education	65	565	1,498	2,978
Business	10,648	143,477	195,223	256,197
Gross Microloans	21,387	276,510	370,523	492,796

Source: RHP, ICICI Direct Research

In the past decade, the Indian financial system has witnessed healthy growth in terms of penetration as well as density of financial products. Growing demand along with the government's effort has led to an improvement in financial inclusion through increased reach across the country. However, distribution of this growth has been uneven among regions. Penetration of formal financial channels has been predominantly concentrated in southern and western regions while eastern and north-eastern regions lagged behind. In terms of per capita retail credit, eastern and north eastern regions score the lowest at ~₹ 4000-6000 per borrower while southern and western regions have per capita retail credit at nearly 5x at ₹ 19000-20000 per borrower.

Exhibit 24: Region wise penetration of banks

	Per million population		Per capita in ₹ 000	
	ATM	Branch	Advances	Deposits
South	292	161	20	89
West	223	124	19	158
North	239	167	14	124
North east	125	85	6	37
Central	115	92	5	40
East	113	84	4	45

Source: RHP, ICICI Direct Research

Exhibit 25: Per capita MFI advances

	Per capita MFI loan (₹)	Loan portfolio (₹ crore)	Clients (in lakhs)	No of players
Assam	16738	703	4	11
West bengal	16722	3244	19	14
Bihar	16492	4024	24	19
Tamil Nadu	17535	3998	23	10
Karnataka	22023	5704	26	11
NBFC - MFI	18017	42701	237	
Bandhan Bank	20363	20078	99	

Source: Company, MFIN Micrometer, ICICI Direct Research

With >80% of Bandhan Bank's advances in the eastern and north eastern region, it has maintained its leadership position in these under penetrated regions. Higher proportion of business has been achieved through increased distribution in eastern and north eastern regions with ~65% of branches. A stronghold in the region and better understanding of the risk profile of the customer can also be seen in relatively higher ticket size offered by the bank. Eastern and north eastern regions, with a ticket size of ~₹ 16500, remain below the national average of ~₹ 18017. Bandhan Bank, however, has been able to maintain higher ticket size at ~₹ 20078, emphasising its strength in terms of customer base and their relationship. **In addition, customer stickiness continues to remain a key driver depicted by the fact that ~65% of customers are vintage customers (customers with a relationship of more than five years) while ~73% of customers are those who have taken advances only from Bandhan Bank.** Going ahead, focus on new geographies is expected to lead to diversification. However, a change in geographical mix is expected to remain gradual with eastern and north eastern regions continuing to remain strongholds for the bank.

Exhibit 26: Break-up of branches, DSCs and advances in East and Northeast region

as % of total	Branch	DSC	Advances
East India	54	52	58
Northeast India	11	17	23
East & Northeast India Total	65	69	81

Source: RHP, ICICI Direct Research

Top micro-finance portfolio (₹ crore)

FY17	Group	MFI loan (₹ crore)
Bandhan Bank	**Private Sector Bank**	**21,380**
Janalakshmi Financial	Small Finance Bank	12,550
Bharat Financial	NBFC – MFIs	9,150
SKDRDP	NBFC – MFIs	6,399
Ujjivan	Small Finance Bank	6,220
State Bank of India	Public Sector Bank	6,130
Andhra Bank	Public Sector Bank	4,930
Satin Credit Care	NBFC – MFIs	3,617
Equitas	Small Finance Bank	3,290
Canara Bank	Public Sector Bank	3,270

Source: RHP, ICICI Direct Research

A unique understanding of customer needs and knowhow of behaviour patterns of the customers in the region acts as a moat for the bank for healthy and profitable credit growth. **Enrolment of new customers in the formal financial segment and increase in ticket size of existing clients are expected to driver future growth. Therefore, AUM growth is seen remaining healthy at 38% CAGR in FY18-20E to ₹ 61546 crore. With higher growth in non-micro loans, proportion of micro loans is seen declining gradually from 84% in FY18 to 78% in FY20E.**

Strong deposit franchisee built in short span of time commendable

One of the commendable features of Bandhan Bank is that it has built up a strong deposit franchise in a very short time period since becoming a bank in 2015. Total deposits have grown from zero as of August 23, 2015, to ₹ 33869 crore as of FY18. CASA deposits, one of the important segments of deposits and one that is difficult to develop, has also risen at a strong pace. As of FY18, CASA deposits were at ₹ 11617 crore, constituting 33.2% of deposits that is relatively better than many regional banks and SFBs. The CASA ratio provides a stable source of low-cost funding, which allows Bandhan Bank to provide cost-effective loans to target its micro finance customer base. This allows the bank to maintain profitable spreads along with growing the portfolio and capture market share. Another strong feature of Bandhan's deposit base is high retail-to-total deposit ratio of 85.1% (it was ~38% of deposits as on FY16), which is sticky in nature compared to bulk deposits.

Exhibit 27: Strong built of deposits and CASA franchise since its inception as a bank

(₹ Crore)	FY16	FY17	FY18	FY19E	FY20E
Deposits	12089	23229	33869	42917	58391
Current Account (CA)	235	1453	2407	3129	4318
Savings Account (SA)	2371	5385	9210	11973	16523
Total CASA	2606	6837	11617	15102	20841
Growth YoY %		162.4	69.9	30.0	38.0
CASA %	21.6	29.4	34.3	35.2	35.7

Source: Company, ICICI Direct Research

Such a strong build-up of deposits in a short period of time by Bandhan Bank is admirable as all banks that have received banking licenses have not succeeded in achieving this. Even micro finance and other NBFCs, which converted into a small finance bank (SFB) in the last two years, lagged behind Bandhan in terms of deposit gathering.

Exhibit 28: Bandhan has high deposits as % of its total borrowings

Deposit as % of total funding (excluding capital)	FY17	Q3FY18
Bandhan	95.8	95.0
Equitas	28.8	44.8
IDFC Bank	44.4	43.7
Ujjivan	3.2	34.6
Federal Bank	94.3	90.3
HDFC Bank	89.7	87.1

Source: Company, ICICI Direct Research

Exhibit 29: CASA ratio at >30% levels

CASA Ratio %	FY17	Q3FY18
Bandhan Bank	29.4	33.2
Equitas SFB	5.0	32.6
IDFC Bank	5.2	10.1
Ujjivan Financial	3.0	3.7
Federal Bank	32.8	33.0
HDFC Bank	48.0	43.9

Source: Company, ICICI Direct Research

Exhibit 30: Scope for more SA accretion remains high for Bandhan Bank

FY18	CA (₹ crore)	SA (₹ crore)	CASA (₹ crore)	CASA %	Branches	SA/Branch
HDFC Bank	119283	223810	343093	43.5	4787	46.8
Axis Bank	95650	148202	243852	53.8	3703	40.0
Kotak Mahindra Bank	32246	65529	97775	50.8	1388	47.2
Yes Bank	28826	44351	73177	36.5	1100	40.3
Indusind Bank	20841	45888	66729	44.0	1400	32.8
SBI	175442	972696	1148138	45.1	22584	43.1
Bandhan	2407	9210	11617	34.3	936	9.8

Source: Company, ICICI Direct Research

Bandhan had a large micro loan customer base of 67 lakh at the time of getting the banking license in August 2015. To complement its micro loan business, the bank has focused particularly on creating a strong general banking business. To this end, it launched its general banking business on August 23, 2015 by opening a greenfield network of 501 bank branches and 50 ATMs. As of FY18, this has grown to 936 bank branches and 430 ATMs, together serving over 25 lakh general banking customers. Including these customers, total customers as of FY18 were at 1.3 crore as on FY18. Micro customers contribute just 6% of the deposit base. Hence, the balance deposit comes from its 25 lakh bank customers.

Further, >2.8x rise in savings deposits in FY16-18 could also be attributed to higher rates offered by Bandhan Bank compared to most other banks. It provides interest rates in the range of 4% to ~6.55% vs. 3.5% offered by many large private and PSU banks.

This extensive footprint that its micro loan business provided allowed it to expand into the general banking market in a way that a new entrant into the market could not, enabling it to tap into the large and growing Indian retail banking market rapidly and profitably. As of FY18, it had 28159 employees. Further, the bank's distribution network is particularly strong in East and Northeast India, with West Bengal, Assam and Bihar together accounting for 56.4% and 57.6% of its branches and DSCs as of FY18, respectively, though its focus is on expanding across India. These regions, in general, have high CASA deposits.

The growth in the bank's deposit franchise has led to a reduction in cost of funding as seen in the below exhibit. Since becoming a bank, Bandhan has lowered interest rates on micro loans from ~22.4% in August 2015 to ~18.4% as FY18. However, during the same period, margins have declined at a slower pace and were at ~8.4% vs. ~9% in FY15. This is due to incrementally lower cost funds on account of raising of deposits and, especially, general CASA deposits that cost lower than the market borrowings.

Exhibit 31: Margins improve over the years despite reducing yields on loans (%)

	FY13	FY14	FY15	FY16*	FY17	FY18E	FY19E	FY20E
YoA	19.1	21.3	21.5	12.4	21.3	16.4	17.5	17.4
CoB	11.0	10.6	11.0	5.5	8.0	6.5	7.5	7.7
NIM	7.5	8.9	9.0	6.4	10.1	8.4	8.9	9.1

*Source: Company, ICICI Direct Research; * In FY16 the numbers look lower as they were impacted owing to transition into a bank from NBFC-MFI*

Exhibit 32: Comparative analysis of yields, cost & NIMs; Bandhan has one of the lowest CoFs

FY18	Yield on advances[%)	Cost of funds (%)	Net Interest margin (%)
Bajaj Finance	18.4	6.7	10.9
Ujjivan Financial	19.6	9	10.6
Bharat financial	19.7	8.7	10.2
Bandhan Bank	**15.4**	**6.7**	**9.7**
Equitas Small	19.7	7.6	8.1
AU Small	14.7	8.4	7.5
HDFC Bank	10.3	4.9	4.3
Kotak Mahindra Bank	10.4	5.1	4.2
Axis Bank	8.5	4.8	3.44

Source: Company, ICICI Direct Research, FY17 data

We expect Bandhan Bank's strength in deposits to continue, going ahead. This is owing to its broad micro banking platform that would provide it with opportunities to receive deposits from relatively underbanked and unbanked segments of Indian society as they become increasingly affluent over time. We expect deposits to increase to ₹ 58391 crore by FY20E, clocking CAGR of 31%. Further, CASA ratio is expected to improve from 34.3% in FY18 to 35.7% by FY20E.

As yield on advances is expected to stabilise at ~16.4% with mild moderation due to rising share in retail proportion of bank loans, lower cost of funds to incremental micro loans should aid margins. Hence, we expect strong NIMs (calculated) of ~9.1% to be maintained in FY18-20E. Net interest income is expected to grow at 38% CAGR in FY18-20E to ₹ 5790 crore.

Continuous focus on cost control supports superior return ratios

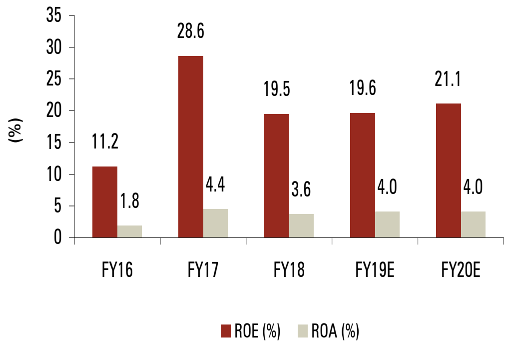
In the financial terrain, scope of control on yield is limited owing to intense competition. Hence, keeping a tight lid on cost is the key to superior returns. Bandhan Bank has been instrumental in keeping a close watch on its cost matrix, which has paid off well in term of lower CI ratio and superior return ratios. Bandhan Bank has been able to consistently keep its CI ratio lower compared to peers at 35% in FY18 and, thereby, generate superior RoA ~4%.

Exhibit 33: Bandhan Bank has relatively lower CI ratio

	ROAA (%)		ROAE (%)		Cost to income (%)	
	FY17	FY18	FY17	FY18	FY17	FY18
HDFC Bank	1.9	1.8	17.9	18.1	43.4	41.0
Axis Bank	0.7	0.0	6.8	0.5	40.9	47.3
Kotak Mahindra Bank	1.7	1.7	13.2	12.5	46.7	47.3
Bandhan Bank	**4.5**	**4.1**	**28.5**	**26.0**	**36.3**	**35.0**
Bajaj Finance	3.2	3.6	21.6	20.2	44.2	42.0
Bharat financial	3.4	3.5	15.1	14.3	61.9	50.4
AU Small	3.2	1.7	20.4	13.7	39.3	55.7
Equitas Small	1.8	0.3	7.6	1.4	70.8	80.0
Ujjivan Financial	2.9	0.1	14.1	0.4	53.6	67.1
Janlakshmi	1.3	NA	9.4	NA	68.1	NA

Source: RHP, Company, ICICI Direct Research

RoA to inch up at ~4% in FY20E



Source: RHP, Company, ICICI Direct Research

In its earlier avatar of NBFC-MFI, Bandhan had witnessed a decline in opex to AUM from ~4.7% in FY13 to ~3.4% in FY15. After getting a banking license, conversion of branches led to a surge in administrative expense. Hence, the opex to AUM ratio increased ~60 bps YoY to ~4% in FY16 and further to 4.3% in FY17. CI ratio also jumped from 29.1% in FY15 to 56.9% in FY16 but moderated to 35% in FY18 as the topline attained traction.

As the bank expands into new geographies and product segments, growth in operating cost is expected to remain elevated led by resource addition (branch and employees) and expenditure related to improvement in IT infrastructure. Hence, operating expense is seen increasing at 36.4% CAGR in FY18-20E to ₹ 2434 crore. However, the CI ratio is expected to remain broadly stable at ~34-35% in FY18-20E. Such focus on opex will enable the bank to maintain better CI ratio compared to peers. With higher traction in AUM, the opex to AUM ratio is also expected to remain steady at 4% in FY20E. Such a check on cost is expected to enable the bank to deliver consistently higher returns. Therefore, we expect RoA to inch up at ~4% in FY20E with RoE seen improving to ~21% in FY20E.

Exhibit 34: CI ratio to inch up in near term; still remain lower than peers (₹crore)

	FY16	FY17	FY18E	FY19E	FY20E
Operating expenses	615.9	1022.0	1308.3	1844.3	2434.0
YoY growth (%)		65.9	28.0	41.0	32.0
CI ratio (%)	56.9	36.3	35.0	34.1	34.3
Opex to AUM (%)	4.0	4.3	4.0	4.1	4.0
Employee cost to AUM (%)	2.1	2.3	2.1	2.2	2.1
Other opex to AUM (%)	1.9	2.0	1.9	2.0	1.9

Source: RHP, Company, ICICI Direct Research

In addition to being extensive, the bank's distribution network is relatively low cost. In particular, this is due to the "hub and spoke" model of using DSCs and associated bank branches and focus on tech initiatives. This low-cost model is demonstrated by operating cost-to-income ratio at 35%

and 36.3% for FY18 and FY17, respectively. The bank operates DSCs and branches on a hub-and-spoke model, whereby, on average, every three to four DSCs are linked to a corresponding bank branch in their area. Customers of these DSCs automatically become customers of associated bank branches, allowing them to open accounts and conduct their banking needs at the associated branch.

Exhibit 35: Scope to improve efficiency of DBOs to enable operating leverage

	Bandhan Bank	Bharat Financial
Number of active micro borrowers	7830000	6188000
Number of borrowers in each group	30.0	21.6
Number of micro groups	261000	286183
Number of DBO	19,500	15418
Number of groups handled per DBO	13.4	18.6
Number of meeting per day *	2.7	3.7

** Assuming 5 days a week*

Source: RHP, ICICI Direct Research

Bandhan Bank has been focused on productivity. Hence, the bank has one of the highest efficiencies among peers. Bandhan Bank has a philosophy of continuous customer engagement through weekly collection model that enables it to keep a close watch on the quality of the portfolio. Currently, the bank has ~78 lakh active borrowers divided into ~2.6 lakh groups wherein each group comprises ~30 borrowers. With a huge strength of ~19500 DBOs, every DBO handles ~13.4 group (potential is ~20 groups per DBO), translating to ~2.7 group meeting per day (assuming a five-day week). Although productivity is best in-class for Bandhan, there is headroom for further improvement on productivity of DBOs.

Exhibit 36: Continuous focus on cost control to strive efficiency bodes well

FY17	No of branches	No of employees	Cost/ branch (₹ crore)	Cost/ employee (₹ lakh)
Bharat financial	1399	14755	0.4	3.7
Equitas Small	600	13367	0.9	4.1
AU Small	284	8515	1.2	4.1
Bandhan Bank	**840**	**24220**	**1.2**	**4.2**
Ujjivan Financial	457	10167	1.0	4.5
Janlakshmi	519	16788	2.3	7.1
Kotak Mahindra Bank	1369	44000	4.1	12.8
Indusind Bank	1200	25314	4.0	18.9
Yes Bank	1000	20125	4.1	20.5
Axis Bank	3304	56617	3.7	21.5
Bajaj Finance	538	11479	4.8	22.3
HDFC Bank	4715	84325	4.2	23.4

Source: RHP, ICICI Direct Research

Asset quality remains stable; unseasoned non-micro book to be watched

Bandhan has achieved consistent growth despite difficult conditions (including crises in Andhra Pradesh and demonetisation) in India's micro finance industry and banking industry. However, the bank has consistently maintained healthy asset quality with GNPA below 1% in FY14-17 despite faster growth in advances and events like demonetisation that impacted the whole sector and the economy.

As of March 31, 2017, Bandhan's gross NPA to gross advance (excluding IBPC/assignment) was at 0.51%. However, an increase in GNPA ratio was seen in 9MFY18 led by higher slippages in agri (₹ 140 crore in 9MFY18 vs ₹ 29.6 crore in FY17) and micro & small enterprise portfolio (₹ 232.9 crore in 9MFY18 vs ₹ 52.6 crore in FY17). As of December 31, 2017, GNPA ratio (excluding IBPC/Assignment) was at 1.67% and improved to 1.25% (+37 bps QoQ), led by growth in the asset base.

Exhibit 37: Asset quality prudent; unseasoned non-micro book remains to be watched

₹ crore	FY16	FY17	FY18	FY19E	FY20E
GNPA					
Micro loans	18.8	86.3	371.8	400.2	525.7
as a % of micro loans	0.2	0.6	1.5	1.2	1.2
Non-micro loans	0.0	0.0	0.0	105.8	150.1
as a % of non-micro loans	0.0	0.0	0.0	1.4	1.2
Total GNPA	18.8	86.3	371.8	506.0	675.8
GNPA (%)	0.2	0.5	1.3	1.2	1.2
NNPA	10.2	61.2	172.9	259.5	365.6
NNPA (%)	0.1	0.4	0.6	0.6	0.7

Source: RHP, Company, ICICI Direct Research

When compared to peers including banks, NBFCs and NBFC–MFI, Bandhan Bank has the lowest GNPA level at 1.25% in FY18 among peers (Exhibit 10). Such a strong asset quality performance is attributable to a group-based individual lending model, focus on income generating loans made to women, strong systems to track loan utilisation, monitor credit and ensure collection and extensive risk management practices, such as lending progressively higher amounts only to members who have built up a track record of good repayment. All this, taken together, have led to low rates of default.

Exhibit 38: Bandhan Bank has lowest GNPA level among peers

	GNPA (%)		NNPA (%)	
	FY17	FY18	FY17	FY18
HDFC Bank	1.1	1.3	0.3	0.4
Axis Bank	5.0	6.9	2.1	3.8
Kotak Mahindra Bank	2.6	2.4	1.3	1.2
Bandhan Bank	**0.5**	**1.2**	**0.4**	**0.5**
Bajaj Finance	1.7	1.5	0.4	0.3
Bharat financial	8.2	2.4	2.7	0.1
AU Small	1.9	2.0	1.2	1.3
Equitas Small	3.5	2.7	1.8	1.4
Ujjivan Financial	3.7	3.6	0.0	0.7
Janlakshmi	8.2	NA	NA	NA

Source: RHP, Company, ICICI Direct Research

Bandhan Bank remains conservative in its approach towards provisioning in lieu of non-performing loans providing for them sooner and in higher amounts than required under RBI regulations. As on December 31, 2017, and for FY17, provision for NPA was at ₹ 202.1 crore and ₹ 25 crore, respectively.

Over the past, the erstwhile NBFC has been into lending micro loans to under and unbanked borrowers. Despite healthy growth, maintenance of prudent asset quality on a consistent basis with GNPA ratio below 1% bodes well for loan monitoring and risk management. Post getting a banking license, the bank has substantial proportion of micro loans (88% of total advances). Factoring in borrower's understanding and risk management framework, GNPA in micro loan is expected to remain stable at ~1.2% in FY18-20E. However, entry in new geographies and segments including SME and retail can throw up challenges in the near term. Loans in new verticals are unseasoned. Therefore, they could surprise on the negative side on credit quality. Adopting a conservative approach, we factor in higher delinquency in non-micro loans with GNPA ratio at 1.4% in FY19E and 1.2% in FY20E. Consequently, overall asset quality may remain prudent with GNPA ratio at 1.2% over FY19-20E.

Strong presence in east…geographic spread to reduce concentration

Bandhan Bank is strong in large scale distribution in unbanked and under banked regions. The erstwhile NBFC had a network of 2,022 doorstep service centres (DSC) and 67.7 lakh micro loan customers. These were transferred to the banking entity (BFSL), which have grown to 2,764 DSCs and 1.06 crore micro loan customers as of FY18. To complement existing micro loan business, since obtaining banking license, the bank has focused particularly on creating a strong general banking business. As of FY18, the network has grown to 936 bank branches and 430 ATM. The bank has 28159 employees across various verticals in the bank.

In terms of geographical spread, Bandhan Bank's network is particularly strong in East and Northeast India, with West Bengal, Assam and Bihar together accounting for 56.37% and 57.58% of branches and DSCs as of December 31, 2017, respectively. In terms of advances, East and Northeast India contributed ~80.9% in 9MFY18. While East and Northeast India are strongholds, the bank is focussing on developing a pan-India network, thereby increasing geographical diversity. Accordingly, the bank has increased its footprint to 33 states and union territories from 24 states and union territories at the time of inception of banking operations. This is expected to lead to a reduction in geographical concentration with contribution from East and Northeast India declining from 80.9% in 9MFY18 to ~78.3% in FY20E.

Exhibit 39: Strong concentration of advances in East, Northeast India at 80.9%

%	9MFY18	FY18E	FY19E	FY20E
Eastern	58.2	58.2	57.7	56.9
Northeastern	22.7	22.7	22.2	21.4
Central	8.7	8.7	9.0	9.5
Western	5.3	5.3	5.6	6.1
Northern	3.6	3.6	3.8	4.1
Southern	1.4	1.4	1.6	1.9
Total AUM	100.0	100.0	100.0	100.0

Source: RHP, ICICI Direct Research

Well capitalised- capital not a concern for robust credit traction

The bank's capital adequacy ratio (CAR) as on FY17 was at 26.4% with Tier I capital at 24.8%. With fresh capital from IPO proceeds added to networth and strong profitability in FY18, the CAR strengthened further to 32.7% with Tier improving to 31.5%. The RBI requires a minimum capital adequacy ratio of 13% of a bank's total risk-weighted assets. With such strong capital adequacy, we expect the bank to continue to clock robust growth for at-least next three to four years without any equity dilution.
However, as per new banking licence shareholding norm from RBI, Bandhan Bank's promoter – Bandhan Financial Holdings is required to reduce its shareholding in the bank to 40% within first three years of commencement of operations, which ends in August 2018. As of March 2018, promoter holding is at ~82.3%. The management has indicated continuous engagement with RBI for an extension of the timeline. Accordingly, the dilution may get an extension of at least two to three years.

Experienced board & management team

The management team has a strong track record and significant experience in the microfinance and banking industries. Founder, Managing Director and Chief Executive Officer, Chandra Shekhar Ghosh, has 37 years of experience in the Indian microfinance industry. Throughout his career, Mr Ghosh has been the recipient of numerous accolades for his contributions to the microfinance sector and designation as a Senior Ashoka Fellow.

Currently, the Board has 12 Directors comprising one Executive Director & eleven Non-Executive Directors. Within these 11 Non-Executive directors, two are Nominee Directors and eight Independent Directors of which one director is a woman.

Exhibit 40: Composition of Board of Directors and Management

Name	Designation	Age
Dr. Ashok Kumar Lahiri	Independent Director (part-time Chairman)	66
Chandra Shekhar Ghosh	MD and CEO	57
Bhaskar Sen	Independent Director	65
Boggarapu Sambamurthy	Independent Director	69
Chintaman Mahadeo Dixit	Independent Director	67
Georgina Elizabeth Baker	Nominee Director	56
Dr. Holger Dirk Michaelis	Nominee Director	48
Krishnamurthy Venkata Subramanian	Independent Director	46
Ranodeb Roy	Non- Executive Director	49
Sisir Kumar Chakrabarti	Independent Director	66
Snehomoy Bhattacharya	Independent Director	65
Thekedathumadam Subramani Raji Gain	Independent Director	56
Sunil Samdhani	CFO	
Indranil Banerjee	Company Secretary	
Arvind Kanagasabai	Head- Treasury	
Biswajit Das	Chief Risk Officer	

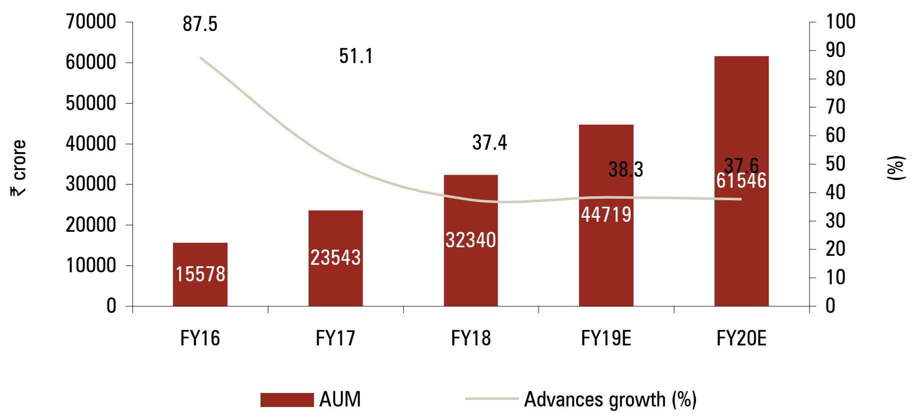
Source: RHP, ICICI Direct Research

Financials

The company has delivered a consistent financial performance and is currently in a strong position to deliver faster and profitable growth ahead. In the past, robust growth in advances at 44.1% CAGR in FY16-18, larger proportion of high yielding micro loans (84% in FY18) and impressive accretion of low cost liabilities (CASA at 34.3% in FY18) has led to strong traction in NII at 80.3% CAGR in FY16-18 to ₹ 3032 crore. Going ahead also, healthy growth in AUM (38% CAGR in FY18-20E) is expected to continue along with margin improvement (as the capital raised during IPO gets utilised). In turn, this is expected to lead to healthy NII growth of 38% CAGR in FY18-20E to ₹ 5790 crore.

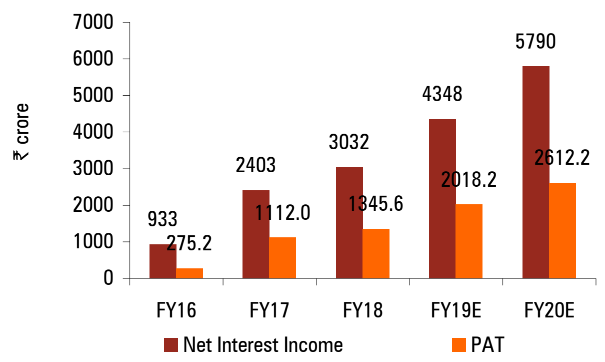
Apart from topline growth, the management's close watch on cost matrix has enabled the bank to keep cost-to-income (CI) ratio lower compared to peers at 35% in FY18. The management has reiterated that its focus on opex control is expected to continue and thus CI ratio would stay at ~34-35% levels by FY20E. We estimate the above factors would allow for healthy growth in PAT for the bank at 39% CAGR in FY18-20E to ₹ 2612 crore. Superiority in terms of return ratios is expected to stay with RoA above 4% and RoE above 20% over FY18-20E.

Exhibit 41: Gross AUM growth to continue strong at 38%



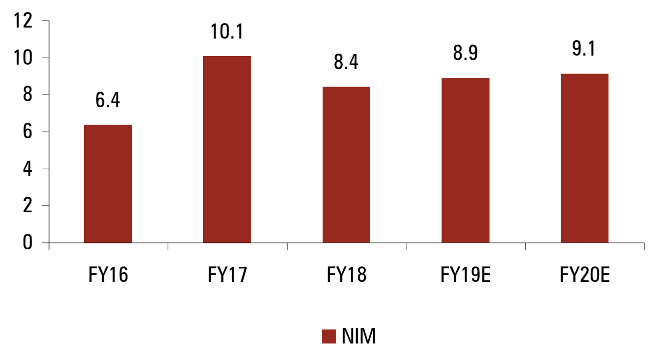
Source: RHP, Company, ICICI Direct Research

Exhibit 42: Strength in net interest income & PAT to continue



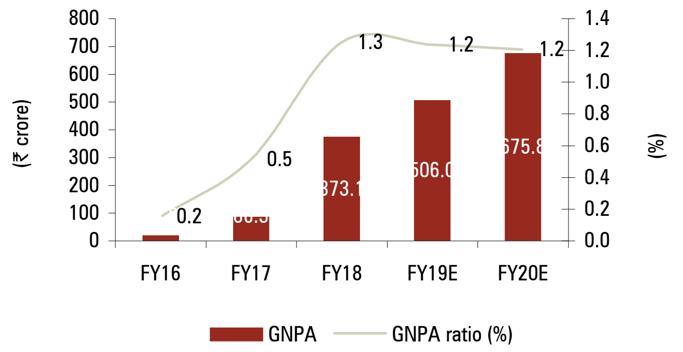
Source: RHP, Company, ICICI Direct Research

Exhibit 43: Margin trends hover around 9% (%)



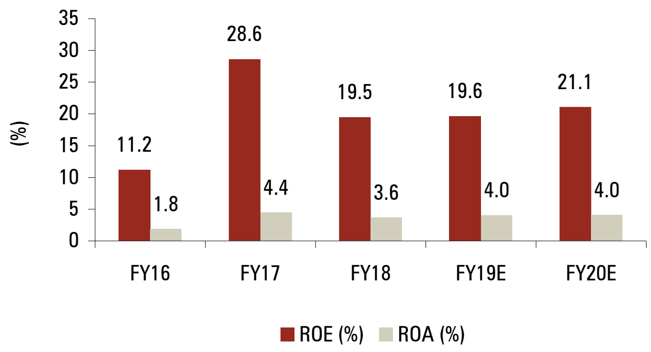
Source: RHP, Company, ICICI Direct Research

Exhibit 44: Asset quality trend stable



Source: RHP, Company, ICICI Direct Research

Exhibit 45: Return ratios above peers consistently



Source: RHP, Company, ICICI Direct Research

Risks and concerns

Concentration risk as substantial operations in eastern India

A substantial proportion of Bandhan's branches & DSCs along with a significant portion of its deposits and advances are in East and Northeast India and, in particular, the states of West Bengal, Bihar and Assam. As on December 17, ~81% of loans, 69% of DSCs and 65% of branches are from these regions. Due to such concentration, the success and profitability of the overall operations may be disproportionately exposed to regional factors that include, among others, increased competition as more players enter these geographies, general economic conditions and other developments including political unrest, floods and other natural calamities.

Major portion of interest from advances due within a year

A substantial portion i.e. ~75.8% of Bandhan's advances have tenures due within a year. The relatively short-term nature of loans means that, while it will have some asset-liability mismatch, the long-term interest income stream is less certain compared to if it had more advances for a longer term. In addition, customers may not avail new advances from Bandhan upon maturity of their existing advances, particularly if competition increases. The potential instability of interest income may materially & adversely affect its results of operations & financial position.

Continuity of management team and skilled personnel

The company's performance is highly dependent on the continued services of its management team. In particular, this includes the efforts of its Managing Director & CEO along with other experienced members of its Board of Directors & senior management. In accordance with requirements prescribed by RBI, the retirement age is 70 years for the managing director, CEO and whole-time directors of the Bank. Bandhan's Managing Director is 57 years old. Any loss of a key personnel or inability to replace key personnel may restrict its ability to grow and manage the overall running of operations.

Reduction in promoter stake to 40% as per RBI norms

As per RBI's new bank licensing guidelines, Bandhan Bank's promoter – Bandhan Financial Holdings Ltd is required to reduce its shareholding in the bank to 40% within the first three years of commencement of operations, ending in August 2018. As of March 2018, the promoter holding was at ~82.3%. The management has indicated at continuous engagement with the RBI for an extension of the timeline. Rejection of an extension on part of the central bank could entail huge equity supply and thereby substantial dilution in performance parameters.

Political risk/monsoon risk weigh on MFI business

With a substantial proportion of loans towards the lower strata of society wherein dependency on agriculture is high, loan repayment is seen being prone to monsoon. Political activities, including loan waiver, have a substantial impact on credit behaviour of borrowers and thereby collection efficiency of micro finance lenders. With India approaching a slew of state elections and general election in the next 12 months, the risk of political volatility cannot be ruled out. Therefore, irregularity in monsoon and political volatility in the region with meaningful exposure could impact asset quality as well as profitability.

Micro credit lending has its unique risks - borrower profile, security, etc

A significant portion of Bandhan's operations remains in extending microloans. As on FY18, ~86% of its net advances consisted of microloans. Thus, the performance could suffer as a result of the disproportionate impact that negative events, impacting its micro banking segment, have on its business. The borrower profile of its microloan customer typically consists of an individual poor woman living in rural India, with limited sources of income, savings and credit histories, and who cannot provide it with any significant collateral (secondary security) for their borrowings. Furthermore, limited financial information is available about Bandhan's focus customer segment from the low-income group. Failure to maintain sufficient credit assessment policies, particularly for individual borrowers, could adversely impact its credit portfolio, which could have a material & adverse effect on its operations.

Valuation

Since its inception as a bank in 2015, Bandhan Bank has been characterised by one of the best parameters among various Indian banks. This is owing to its unique business model wherein the asset side is largely focused on high yielding micro finance loans while the liability side is focused on gathering low cost retail deposits. The key strength of Bandhan Bank is that it has been able to manage the granularity well on both asset side (low ticket loan customers) as well as deposits side. This is very difficult to achieve. Thus, the bank has been able to generate strong return ratios over the years with RoA of 4.1% and RoE (before adjusting for capital raised) at 26% for FY18. Post its IPO issue, calculated RoE post capital infusion for FY18 moderated to ~19.5%, mainly due to higher capital inflow due to the requirement of mandatory listing within three years of bank formation.

Exhibit 46: : Fundamental analysis of peers – better metrics warrant higher multiple

	Return on average assets (%)		Return on average equity (%)		Net Interest margin (%)		Cost to income (%)		Gross non performing assets (%)	
	FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18
HDFC Bank	1.9	1.8	17.9	18.1	4.2	4.3	43.4	41.0	1.1	1.3
Axis Bank	0.7	0.0	6.8	0.5	3.2	3.4	40.9	47.3	5.0	6.9
Kotak Mahindra Bank	1.7	1.7	13.2	12.5	4.0	4.2	46.7	47.3	2.6	2.4
Bandhan Bank*	4.5	4.1	28.5	26.0	10.4	9.7	36.3	35.0	0.5	1.2
Bajaj Finance	3.2	3.6	21.6	20.2	9.4	10.9	44.2	42.0	1.7	1.5
Bharat financial	3.4	3.5	15.1	14.3	10.1	10.2	61.9	50.4	8.2	2.4
AU Small	3.2	1.7	20.4	13.7	10.8	7.5	39.3	55.7	1.9	2.0
Equitas Small	1.8	0.3	7.6	1.4	9.2	8.1	70.8	80.0	3.5	2.7
Ujjivan Financial	2.9	0.1	14.1	0.4	11.4	10.6	53.6	67.1	3.7	3.6
Janlakshmi	1.3		9.4		12.0		68.1		8.2	

** Return on Equity (RoE) is as reported by the company*

Source: Company, RHP, ICICI Direct Research

As an NBFC, Bandhan was levered around 5-6x range but owing to high capital raised in IPO, leverage went down to <4.5x in FY18. As leverage increases with increase in assets, we estimate calculated RoE will expand in future to 21.1% by FY20E. Bandhan Bank is one of the few banks that would not need to raise capital for at-least next three to four years as its Tier-I ratio is 31.5% as on FY18. Consistently, strong RoAs of ~4%, led by strong margins and lower than peers cost-to-income ratios is expected to continue ahead. We expect AUM book to grow at 38% CAGR to ₹ 61546 crore with PAT surging at 39% CAGR in FY18-20E to ₹ 2612 crore

One of the banks similar to Bandhan with high NIM at ~4.2%, reasonable CI ratio at ~43%, PAT growth at ~21%, generating RoA and RoE of ~1.9% and ~18%, respectively, a strong top management and trading at rich valuations is HDFC Bank. It is trading at 3.5x P/ABV and 22x P/E on FY20E basis. We value HDFC Bank at a target price of ₹ 2300 valuing at 3.8x P/ABV of FY20E and 24x P/E. Bandhan Bank, with almost double NIM and RoA vs. HDFC Bank and lower CI ratio with no legacy corporate portfolio pain, is expected to continue to command higher premiums on the valuations front. Even comparing with Bajaj Finance having similar return ratios, Bandhan Bank is now giving returns in a bank format vs an NBFC. We are still valuing Bandhan similar to Bajaj Finance on a P/BV basis.

Exhibit 47: Valuation Comparison

	ROA			ROE			P/E			P/BV		
	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Bandhan Bank	3.6	4.0	4.0	19.5	19.6	21.1	43.4	29.0	22.4	6.2	5.2	4.3
Bharat Fin	4.2	4.0	4.0	16.9	28.1	25.4	36.0	22.2	16.9	5.5	4.3	3.4
AU Small Fin	3.6	3.3	2.9	18.2	19.3	19.3	67.9	48.1	32.4	8.7	7.5	6.1
Equitas	0.4	1.2	1.6	1.8	7.8	11.2	171.1	30.6	18.2	2.3	2.2	1.9
HDFC Bank	1.8	1.8	1.9	18.1	17.1	16.6	29.3	25.3	21.0	5.0	3.7	3.3
IndusInd Bank	1.8	2.0	2.0	16.5	18.7	19.4	31.6	23.9	19.5	4.9	4.1	3.5
Kotak Bank	1.7	1.8	1.9	12.5	13.2	14.8	61.4	48.4	39.2	7.1	6.5	5.8

Source: Company, RHP, ICICI Direct Research

At the current price of ₹ 490, Bandhan Bank is available at a multiple of 4.4x FY20E ABV of ₹ 111. This multiple is ~80-90 bps higher than HDFC Bank. On a P/E basis, it is available at ~22x FY20E earnings, similar to HDFC Bank. Valuing Bandhan Bank at 5.4x FY20E ABV, which is 27x FY20E EPS, we arrive at target price of ₹ 600 from a 12 months perspective. We initiate coverage on Bandhan Bank with a **BUY** recommendation.

Exhibit 48: Financial Summary

₹ crore	FY16	FY17	FY18	FY19E	FY20E
Net Interest Income	932.8	2403.5	3032.2	4347.7	5790.3
Pre Provisioning Profit	466.8	1792.9	2430.1	3567.2	4656.3
Net Profit	275.2	1112.0	1345.6	2018.2	2612.2
EPS (₹)	2.5	10.2	11.3	16.9	21.9
ABV (₹)	30.4	40.0	77.2	91.6	110.8
GNPA (%)	0.2	0.5	1.3	1.2	1.2
RoE (%)	11.2	28.6	19.5	19.6	21.1
RoA (%)	1.8	4.4	3.6	4.0	4.0

Source: RHP, Company, ICICI Direct Research

Insight into M&A deals in MFI space

An analysis of various M&A deals that happened in the recent past in the MFI industry and peers engaged in MFI business indicates that Bandhan Bank has been commanding a premium with respect to MCap per customer at ₹ 48,109 compared to peers ranging between ₹ 2,500 and ~₹ 22000 per customer. A stronghold in the east, northeast region and better understanding of risk profile of customer has enabled Bandhan Bank to garner relatively higher ticket size compared to peers. This along with focus on cost control has led to higher profitability indicated by profit per customer at ₹ 1,121 compared to ₹ 645 by BSS Microfinance (acquired by Kotak Mahindra Bank) and ₹ 500 for Grama Vidyal Micro Finance (acquired by IDFC Bank). Therefore, Bandhan Bank, with a relatively large balance sheet, strong management, universal banking license and ability to earn higher profitability per customer is seen continuing to command a higher premium on the valuations front.

Exhibit 49: Market cap to customer analysis

₹ crore	Mcap	No of clients (in Lakhs)	Networth	Advances	Advances per customer (₹)	PAT per customer (₹)	Mcap per customer (₹)
Ujjivan Financial	4612	37.1	1761.4	7560	20377	20	12431
Bandhan Bank	57731	120	9382	32340	26950	1121	48109
Kotak Bank - BSS Microfinance	139.2	2.17	73	483	22258	645	6415
IDFC Bank - Grama Vidiyal Micro Finance	300	12	NA	1502	12517	500	2500
Bharat Financial Inclusion Ltd	16008	73	2999	12,594	17252	623	21929

Source: RHP, Company, Media articles, ICICI Direct Research

Financial Summary

Exhibit 50: Profit and Loss Statement

(₹ Crore)	FY17	FY18	FY19E	FY20E
Interest Earned	3908.7	4802.3	7040.5	9422.5
Interest Expended	1505.2	1770.1	2692.8	3632.3
Net Interest Income	2,403.5	3,032.2	4,347.7	5,790.3
growth (%)	157.7	26.2	43.4	33.2
Non Interest Income	411.4	706.2	1063.8	1300.0
Operating Income	2814.9	3738.4	5411.5	7090.3
Staff cost	545.6	688.0	963.7	1282.4
Other Operating expense	476.4	620.3	880.6	1151.5
Operating profit	1792.9	2430.1	3567.2	4656.3
Provisions	88.4	374.2	462.4	637.6
Exceptional items	0.0	0.0	0.0	0.0
PBT	1704.5	2055.9	3104.9	4018.8
Taxes	592.5	710.3	1086.7	1406.6
Net Profit	1112.0	1345.6	2018.2	2612.2
EPS (₹)	10.2	11.3	16.9	21.9

Source: RHP, Company, ICICI Direct Research

Exhibit 51: Balance Sheet

(₹ Crore)	FY17	FY18	FY19E	FY20E
Sources of Funds				
Capital	1095.1	1192.8	1192.8	1192.8
Reserves and Surplus	3351.3	8189.1	9992.6	12390.1
Networth	4446.5	9381.9	11185.4	13582.9
Deposits	23228.7	33869.0	42917.1	58391.1
Borrowings	1028.9	285.0	356.3	498.8
Other Liabilities & Provisions	1532.0	774.1	928.9	1161.2
Total	30236.1	44310.0	55387.6	73633.9
Applications of Funds				
Fixed Assets	251.8	238.1	285.7	342.9
Investments	5516.5	8371.9	8605.6	11187.2
Advances	16839.1	29713.0	41013.6	56076.0
Other Assets	7628.7	5987.0	5482.7	6027.8
Total	30,236.1	44,310.0	55,387.6	73,633.9

Source: RHP, Company, ICICI Direct Research

Exhibit 52: Key Ratios

(Year-end March)	FY17	FY18	FY19E	FY20E
Valuation				
No. of Equity Shares (Crore)	109.5	119.3	119.3	119.3
EPS (Rs.)	10.2	11.3	16.9	21.9
BV (Rs.)	40.6	78.7	93.8	113.9
ABV (Rs.)	40.0	77.2	91.6	110.8
P/E	48.3	43.4	29.0	22.4
P/BV	12.1	6.2	5.2	4.3
P/ABV	12.2	6.3	5.3	4.4
Yields & Margins (%)				
Net Interest Margins	10.1	8.4	8.9	9.1
Yields on Loans	17.4	14.9	16.6	16.4
Cost of funds	8.0	6.5	7.5	7.7
Quality and Efficiency (%)				
Cost to income ratio	36.3	35.0	34.1	34.3
GNPA	0.51	1.25	1.23	1.21
NNPA	0.36	0.58	0.63	0.65
ROE	28.6	19.5	19.6	21.1
ROA	4.4	3.6	4.0	4.0

Source: RHP, Company, ICICI Direct Research

Exhibit 53: Dupont analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Interest income	15.6	12.9	14.1	14.6
Interest expense	6.0	4.7	5.4	5.6
Net interest income	9.6	8.1	8.7	9.0
Other income	1.6	1.9	2.1	2.0
Total income	11.3	10.0	10.9	11.0
Employee expenses	2.2	1.8	1.9	2.0
Other operating expenses	1.9	1.7	1.8	1.8
Total operating expenses	4.1	3.5	3.7	3.8
Pre provisioning profits	7.2	6.5	7.2	7.2
Provisions	0.4	1.0	0.9	1.0
Pre tax profits	6.8	5.5	6.2	6.2
Tax	2.4	1.9	2.2	2.2
RoA	4.4	3.6	4.0	4.0

Source: RHP, Company, ICICI Direct Research

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