

CMP: INR295

Coverage Suspended



Bandhan Bank acquires Gruh Finance in an all-stock deal

GRUH Finance (GRHF) and Bandhan Bank (Bandhan) has announced a scheme of amalgamation and according to the share swap ratio, for every 1,000 shares of GRHF shareholders will get 568 shares of Bandhan. This is at an ~8% discount to the closing price of GRHF as of 7 Jan'19 and at a ~2.5% premium to the last six months average price. **Following this event, GRUH Finance will cease to be a part of our coverage universe.**

- Post amalgamation, Bandhan will have strong presence in the affordable housing segment. This will also help Bandhan to increase its reach in the western region. The share of unsecured loan book will decline to 57% v/s 86% as of 1HFY19. Promoter shareholding of Bandhan will fall to 61% v/s 82.3% as of now. This will take Bandhan a step closer to fulfil the 40% promoter shareholding requirement.
- The biggest advantage for GRHF is access to a stable source of funding and ability to expand its presence in the eastern region on the back of Bandhan's branch network. Any future regulatory issue due to overlapping of business with the parent would be avoided.
- HDFC Ltd will become the largest shareholder (Post Promoter) of Bandhan with ~15% shareholding. According to regulations, HDFC Ltd can a maximum hold 9.9% in any banking entity, subject to regulatory approval, and hence, we expect at least ~5% stake sale in future from HDFC Ltd in Bandhan (~INR40b based on combined MCAP of INR806b).
- Combined entity market cap will increase to ~INR806b. Based on consensus estimates and amalgamation ratio FY19 PBV of the combined entity will be 6.2x. Further, there will not be any meaningful impact of negative carry on CRR and SLR. Note, we have not considered the synergy on account of lower cost of operations and PSLC fee income benefit on GRHF's portfolio. Hence, for a combined entity we don't see any Profit impact.
- Based on the share swap ratio, Bandhan will see BV and EPS dilution (on proforma merged) of 14% and 9%(FY19E), respectively. The deal is subject to regulatory and shareholder approval. We expect GRHF's share price to now track the share price of Bandhan. **Since we don't have a rating on Bandhan, we withdraw our rating on GRUH Finance.**

Combined entity balance sheet at ~INR693b with diversification in loan book

Combined balance sheet of amalgamated entity will be ~INR693b and net worth will be ~INR119b based on 1HFY19 financials. Biggest advantage of the merger for Bandhan Bank will be a sharp increase in the secured loans share to 32% v/s 14% (non-MFI) as of 1HFY19. Further, expertise of GRHF can be utilised to cross-sell products in the strong presence of Bandhan in the eastern region and micro-loan customers.

Bandhan - one step closer to fulfil the RBI's shareholding requirement

One of the biggest regulatory issues is Bandhan Bank's compliance with the regulatory requirement of shareholding. As of 1HFY19, promoters held 82.3% shareholding in the bank and post deal it would come down to 61%. Bandhan promoters will have to reduce their shareholding to ~40% at the earliest to comply with the regulatory requirements.

A win-win deal for HDFC

HDFC Ltd incrementally has increasing share of affordable housing both in volume and value terms. There has been an overlap in the business of both GRHF and HDFC Ltd, especially in the western region. HDFC could monetize its investment in GRHF at a very attractive valuation (13.3x Trailing BV). Post deal, HDFC Ltd will have ~15% stake in the bank. According to regulations, it can own a maximum stake of ~9.9% in another bank (as already shareholder in HDFCB) subject to regulatory approval. If it sells ~5% stake, then it can fetch INR40b (based on combined MCAP of INR806b on the deal value).

However, since we don't have a rating on Bandhan Bank, we withdraw our rating on GRUH Finance.

Exhibit 1: The merger works out to be 14% dilutive on book value basis; while EPS dilution on FY19E basis works out to be 9%

1HFY19	Gruh	Bandhan	Merged Entity
Share Capital (INRm)	1,465	11,928	16,088
Reserves and Surplus (INRm)	15,153	90,147	1,02,604
Net-worth (INRm)	16,617	1,02,075	1,18,692
Outstanding shares (m)	732	1,193	1,609
Swap Ratio	1,000	568	NA
New Bandhan Shares to be issued (m)		416	
BV (INR)	23	86	74
Dilution to Book value (%)			-14%
Share Price (INR)	306	501	501
Current Mkt Cap(INRm)	2,24,114	5,97,593	8,06,010
Discount to CMP based on swap ratio	-7.5%		
Implied Multiple (Trailing)		5.9	6.8
FY19e	Gruh	Bandhan*	Merged Entity
PAT (INRm)	4,499	19,583	24,082
EPS	6.1	16.4	15.0
Dilution in EPS			-9%

*FY19 PAT estimates for Bandhan are from Bloomberg

Source: MOSL, Company

Exhibit 2: Swap Ratio – 416m (35% increase) shares of Bandhan Bank to be issued

As of 2QFY19	Gruh	Bandhan Bank
Existing No. of shares (No. mn)	732	1,193
Face Value	2	10
Swap ratio	1,000	568
New Bandhan Shares to be issued (Nos mn)		416
Total No. of shares post-merger		1,609
% increase in No. of shares		35%

Source: MOSL, Company

Exhibit 3: Shareholding as of 2QFY19-Bandhan Bank

Bandhan	%	No.of shares
Promoter's	82.3%	981.4
Others	17.7%	211.4
Total	100.0%	1,193

Source: MOSL, Company

Exhibit 4: Shareholding as of 2QFY19-Gruh Finance

Gruh	%	No.of shares
Promoter's	57.9%	423.8
Others	42.1%	308.6
Total	100.0%	732.4

Source: MOSL, Company

Exhibit 5: While the promoter shareholding is expected to come down to 61% ; HDFC will continue to hold ~15% in Bandhan bank, post-merger

Merged entity	%	No. of shares
Promoter's	61.0%	981.4
HDFC LTD	15.0%	240.7
Others	24.0%	386.7
Total	100.0%	1,609

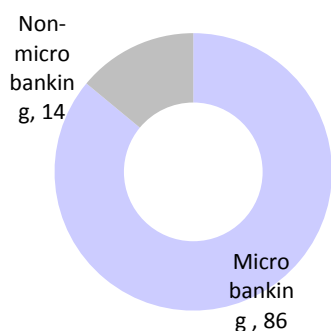
Source: MOSL, Company

Exhibit 6: ~60% of the total branches post-merger will be in the eastern and the western region

Nos.	GRUH		Bandhan Bank		Merged Entity
	FY18	1HFY19	FY18	1HFY19	1HFY19
East	2%	2%	52%	51%	43%
North East	0%	0%	15%	14%	12%
North	3%	3%	6%	6%	5%
West	58%	58%	9%	8%	17%
South	15%	15%	4%	4%	6%
Central	23%	23%	0%	0%	4%

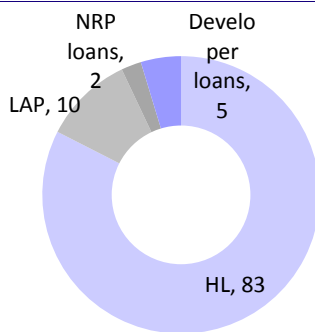
Source: MOSL, Company

Exhibit 7: Loan mix as of 2QFY19-Bandhan Bank



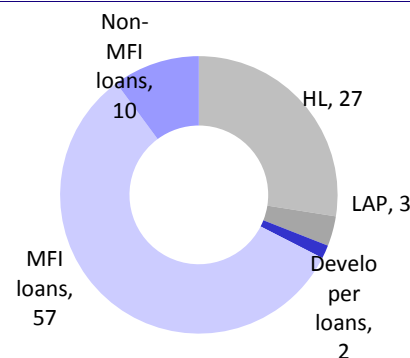
Source: MOSL, Company

Exhibit 8: Loan mix as of 2QFY19- Gruh Finance



Source: MOSL, Company

Exhibit 9: Loan mix as of 2QFY19-Merged entity



Source: MOSL, Company

Exhibit 10: PAT accretion post regulatory (CRR,SLR) requirements assuming 100% liability cost re-pricing

INRm	1HFY19
Borrowing	1,64,895
New borrowing (estimated)	2,16,967
Addition of borrowings	52,072
-CRR	8,679
-SLR	43,393
CRR cost	655
SLR Cost	21
Total SLR/CRR drag (A)	676
Funding benefit (100 bps for Gruh) (B)	2,170
Net benefit (B) – (A)	1,493
Tax rate (34%)	508
Net PAT benefit	986

Source: MOSL, Company

Exhibit 11: Performance snapshot

INRm	GRUH		Bandhan Bank		Merged Entity
	FY18	1HFY19	FY18	1HFY19	1HFY19
Profit & Loss					
NII	6,409	3,795	30,322	21,146	-
PPoP	6,006	3,139	24,301	16,945	-
PAT	3,627	2,206	13,456	9,694	-
Balance Sheet					
Networth	14,411	16,617	93,819	1,02,075	1,18,692
Deposits	14,488	14,841	3,38,690	3,29,589	3,44,429
Borrowings	1,25,877	1,50,054	2,850	14,217	2,16,344
Other Liabilities	4,847	3,521	7,741	10,162	13,683
Total Liabilities	1,59,623	1,85,033	4,43,101	4,56,044	6,93,149
Investments	1,531	2,098	83,719	85,787	87,885
Advances	1,55,685	1,66,629	2,97,130	3,17,298	4,83,926
Fixed Assets	154	153	2,381	2,198	2,351
Other Assets	2,253	16,154	59,870	50,761	1,18,987
Total Assets	1,59,623	1,85,033	4,43,101	4,56,044	6,93,149
Asset Quality					
GNPA	701	1,455	3,731	4,133	5,588
NNPA	-	843	1,729	2,204	3,047
GNPA (%)	0.45%	0.88%	1.25%	1.29%	1.15%
NNPA (%)	-	0.51%	0.58%	0.69%	0.63%
Ratios					
Tier 1	17.68%	NA	30.38%	31.49%	-
CRAR	18.90%	NA	31.48%	32.59%	-
Others					
Branches	194	194	936	938	1,132
DSCs	-	-	2,764	3,010	3,010

Source:

NOTES

Explanation of Investment Rating

Investment Rating

BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10% to 15%
UNDER REVIEW	Rating may undergo a change
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