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RBL Bank Ltd.

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Riding on high growth momentum…

RBL Bank Ltd. has emerged as one of the fastest growing private sector banks with a network of 215 branches and 374 ATMs.

Investment Rationale

Transformation under way: The transformational journey of RBL Bank started in 2010 when the new management team took charge led by MD & CEO Mr Vishwavir Ahuja, who was previously serving as MD & Country CEO of Bank of America for the Indian subcontinent. Under his vision and leadership, the bank has repositioned itself from being a traditional bank to a new age bank competing with other private sector banks. The bank is increasingly focusing on the lucrative retail segment instead of focusing on just corporates and SMEs. Further, the bank has invested significantly in technology, network, human capital and risk management over the past six years. Hence, we believe the bank has a promising future and is well positioned to tap the strong growth opportunities available in the banking space.

Focused approach to support robust growth momentum: RBL Bank has adopted both organic as well as inorganic strategy to sustain strong growth momentum over the last five years. Organically, the bank has been focusing on selective segments to drive profitable growth by catering to the funding and working capital needs of large and mid-sized corporates. To push its retail business, it acquired the credit card & mortgage business of The Royal Bank of Scotland (RBS) and has been expanding the same along with other new retail products (38% of its total advances). As a result, the bank reported scorching growth of 82% CAGR in earnings, 60% CAGR in deposits and 58% CAGR in advances over FY11-FY17 resulted in increase in market share to 0.3% from as low as 0.1% in FY12. We expect the bank to continue to increase its market share with a robust CAGR of 31% in advances over FY17-19E.

Strong growth without compromising on asset quality: While the new management has been aggressive in expanding the loan book, it has put an efficient risk management system in place to manage asset quality. This has led to Gross NPAs being contained below 1% over the last five years. Hence, going forward, we expect the overall asset quality to remain broadly stable (Gross NPA at 1.3% and Net NPA at 0.4% by FY19E) given the strong risk management practices and an improving macro environment.

Valuation: We expect the bank to deliver 37% earnings CAGR over FY17-19E coupled with improving return ratios (RoE of 16.3% and RoA of 1.2% by FY19E). We believe higher earnings growth, steady asset quality, improving business mix and loan growth above industry average will continue to drive re-rating of the stock. Further, RBL Bank will retain the tag of “one of the fastest growing banks” over FY17-19E given its strong footprint across all the business segments. Thus, we recommend a BUY rating and assign a TP of Rs630 (P/ABV of 4.5x for FY19E).

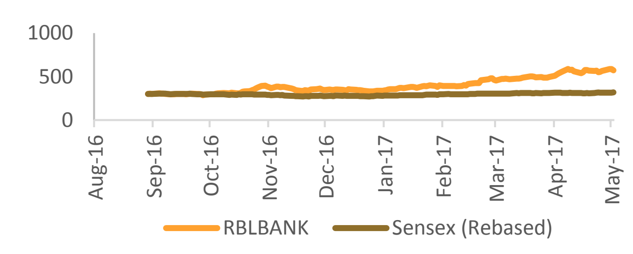
Market Data

Rating	**BUY**
CMP (Rs.)	561
Target (Rs.)	630
Potential Upside	12%
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	600/274
Adj. all time High (Rs.)	600
Decline from 52WH (%)	6.5
Rise from 52WL (%)	104.9
Beta	0.8
Mkt. Cap (Rs.Cr)	21,040

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Net Interest Income (Rs. Cr)	819	1,221	1,599	2,095
Pre Pro Profit (Rs. Cr)	542	920	1,198	1,656
EPS (Rs.)	9.4	11.8	16.5	22.4
P/E (x)	58.4	44.5	34.1	25.0
P/BV (x)	6.1	4.9	4.4	3.8
P/ABV (x)	6.4	5.1	4.5	4.0
ROE (%)	11.2	12.2	13.5	16.3
ROA (%)	0.9	1.0	1.1	1.2
Net Interest Income (Rs. Cr)	819	1,221	1,599	2,095

One-year Price Chart



Shareholding Pattern	Mar-17	Dec-16	Chg.
Promoters (%)	-	-	-
Public (%)	100.0	100.0	-

RBL Bank Ltd. - Company Overview

RBL Bank Ltd, the erstwhile Ratnakar Bank Ltd, has a long history in India with operations since 1943 when the bank was incorporated as a small regional bank in Maharashtra with two branches in Kolhapur and Sangli. The bank has been in existence for the last 73 years and it has successfully transformed itself from a traditional bank to a new age bank over the last six years. In June 2010, Ratnakar bank appointed Mr. Vishwavir Ahuja as managing director and CEO to lead the bank's transformation.

In the past five years, the bank has focused on building a comprehensive product suite, improving risk management, upgrading technology by implementing a new-age core banking system platform and expanding its distribution network to 215 branches and 374 ATMs. As part of its growth strategy, the bank acquired certain Indian businesses of RBS in FY14, including RBS's business banking and its credit card and mortgage portfolios. It provides a wide range of customized banking products and services to large corporations, SMEs, agricultural customers, retail customers and low income customers.

Well diversified product portfolio

Prior to 2010, the bank was largely involved in commercial (SME/mid-corporate) banking in Maharashtra and Karnataka. However, under the new management, RBL Bank has adopted a differentiated approach of building a diversified loan book using a unique positioning strategy. The business segments were reorganised into two verticals viz. wholesale and retail. The wholesale business segment consists of Corporate and Institutional Banking ("C&IB") and Commercial Banking ("CB") whereas the retail business segment includes Branch and Business Banking ("BBB"), Agribusiness Banking ("AB"), Development Banking and Financial Inclusion ("DB&FI") and Treasury and Financial Markets Operations. We believe this diversification will help the bank in sustaining strong business growth. Moreover, one of the core tenets assimilated with these business segments is to cross-sell the products and solutions of the entire bank.

The retail loan book grew at a scorching pace of 64% CAGR over FY13-17. As a result, its share in the loan book climbed to 39% as of FY17 as compared to 25% in FY13. Although the wholesale loan book grew at a strong pace of 39% CAGR over FY13-17, its share in the loan book declined to 61% as of FY17 from 75% in FY13. Eventually, the bank is targeting to balance both the portfolios largely in equal proportion. Hence, we expect retail loan book (34% CAGR) to continue to outpace wholesale loan book (29% CAGR) growth over FY17-19E.

C&IB – Quality lending to drive business growth

Under the C&IB segment, the bank gives working capital loans to large corporates having a turnover of over Rs1,500cr. However, the bank has been selective in lending to large corporates and is strongly focused on the quality of business originated from such clients. The ticket size of these loans varies from Rs5cr to Rs40cr with tenure of less than 2 years. Moreover, about 22% exposure in the segment is non-fund based (LCs, remittances, etc). Going ahead, the bank plans to focus on its non-fund based business with an aim to increase the proportion of its fee income. C&IB remains one of the key growth drivers for RBL Bank. C&IB's loan book grew at a robust CAGR of 45% over FY13-17 and accounted for 42% of the loan book as of FY17. Given the bank's strong presence and significant competencies in such segment, we believe the current growth momentum to continue and forecast C&IB's loan book to grow at 33% CAGR over FY17-19E.

CB – Focus on increasing fee income to improve profitability

In the CB segment, RBL bank provides loans to small and medium enterprises (SMEs) having a turnover of Rs250-1,500cr. The ticket size of these loans ranges from Rs5cr to Rs15cr for a tenure of less than 2 years. Further, the bank's focus is on getting transaction banking business to beef up its fee income and boosting current account (CA) floats. The CB portfolio grew at a 29% CAGR over FY13-17, accounting for 19% of the bank's loan book as of FY17. As the bank is likely to focus mainly on fee income, we expect the CB's loan book to grow at a slower than historical but healthy pace of 20% CAGR over FY17-19E.

BBB – Main growth engine of the bank

Branch and Business Banking (BBB) focuses on SMEs and MSMEs clients with high-volume transaction banking requirements (in turn working capital) and contribute significantly to its relatively strong current account franchise. Further, it also focuses on the retail business of the bank. In urban locations, the bank targets credit cards, small enterprise loans and personal loans to salaried individuals. The bank also originates home loans for HDFC, India's largest housing finance company. The loan book of BBB segment comprises of 53% LAP (loan against property), 14% business loans, 13% credit cards, 5% personal loans and other smaller loans. The acquisition of the Royal Bank of Scotland (RBS) portfolio provided the bank with an access to a strong customer base and helped it to report stellar 67% CAGR in BBB's loan book over FY13–17. This business accounts for 18% of the loan book as of FY17 and is expected to be the growth engine for the bank in coming years. Moreover, RBL Bank recently entered into an agreement with Bajaj Finance Ltd. (BFL) for launching series of co-branded credit cards (CCs). The CCs will be offered to BFL's existing as well as new customers, thus expanding the bank's scope of growth in the CC segment. Hence, we believe the bank will be able to maintain its strong growth momentum in the segment and expect it to grow at 35% CAGR over FY17-19E.

AB – Well set to drive sustainable growth

AB services the customers involved in agriculture and allied activities. The bank offers loans to farmers directly and also lends through tie-ups with agri input providers. While most banks consider the agriculture segment as an obligation (priority sector lending targets), RBL bank has adopted a differentiated approach in creating sustainable profit pools in this segment. The bank has also set up regional agricultural business credit and operation hubs to facilitate efficient delivery of banking services to its AB customers. The bank's deep understanding of the agriculture value chain and prudent lending norms give it a competitive advantage over peers. Thus, the bank reported 78% CAGR (albeit on a low base) in AB's loan book over FY13–17. This business accounts for 7% of the loan book. We believe the bank's differentiated agri-business model will continue to help it to report healthy CAGR of 30% in loan book over FY17-19E.

DB&FI – Expanding through carefully selected partners

This segment focuses on low-income households and includes certain other categories such as women borrowers and small farmers. The bank uses a group approach to such customers and lends through joint liability groups and self-help groups. Apart from directly lending to individuals, the bank also lends to financial intermediaries such as MFIs, HFCs involved in affordable housing finance and NBFCs engaged in lending to MSMEs. RBL bank has adopted a multi-product strategy wherein it cross-sells remittances, savings deposits and insurance products in addition to loan products. Moreover, the bank invested in Swadhaar Finserv Private Ltd., a business correspondent (BC) engaged in offering products and services to inadequately served sections of businesses, households and enterprises. DB&FI's loan book grew at a robust pace of 55% CAGR over FY13-17 and constituted for 14% of the loan book as of FY17. Further, it has also recently acquired 10% stake in Utkarsh Micro Finance Private Limited (UMFI), a microfinance institution (MFI) with a small finance bank (SFB) license. Hence, we expect the DB&FI's's loan book to grow at 35% CAGR over FY17-19E.

Multi-pronged distribution network

In the past five years, the bank has grown from a regional bank concentrated in the states of Maharashtra and Karnataka to a bank having a vast network of 215 branches across 18 Indian states and union territories as of Q3FY17. The bank expanded its branch network along the NH-8 belt, a national highway that connects Delhi to Mumbai via Gujarat and Rajasthan and the NH-4 belt connecting Mumbai to Chennai along Maharashtra, Karnataka, and Tamil Nadu. Further, the bank has entered exclusive partnership agreements with business correspondents to establish transaction points and provide remittance services. The bank has established more than 8,000 transaction points to enable migrant remittances, receipt of government subsidies, and Aadhar-based banking transactions. It is also focusing on technology as its last-mile connector to customers and has developed cost-efficient micropayment and branchless banking solutions.

RBL Bank's Vision 2020

The bank has set a robust growth plan in its 'Vision 2020'. While the bank has set aggressive growth targets, RBL Bank has so far exceeded the same. Going ahead, we expect the bank to continue to grow at a healthy pace coupled with better-operating efficiencies.

RBL Bank's Vision 2020

	RBL Vision 2020	Actual 9M FY 17
Advances	30-35% CAGR	46%
CASA Ratio	0.75 - 1% increase every year	March 31, 2016: 18.6% December 31, 2016: 23.2%
Other Income %	~ 1/3rd of Net Total Income	37.4%
Operational Efficiency	Cost/Income ratio of 51% - 52% by 2020	March 31, 2016: 58.6% December 31, 2016: 54.0%
Return Ratios	~ 1.50% RoA by 2020	March 31, 2016: 0.98% December 31 2016: 1.08%*

Source: Company, In-house research

Loan book to grow at 31% CAGR over FY17-19E

RBL bank’s advances witnessed a CAGR of 58% over FY11-17 backed by both organic as well as inorganic business expansion strategy. Notably, the industry credit grew at a CAGR of ~13% in the same period. However, the bank's market share is still minuscule (~0.3%) despite such a strong growth over the past five years. Hence, we expect the bank to continue to gain market share driven by the economic recovery and its well-incentivized workforce. Further, with robust growth in the retail advances, the overall advances are expected to grow at a robust pace of ~31% over FY17-19E.

Robust deposit growth to be supported by CASA

Similar to advances, RBL bank’s deposits grew at a robust pace of 60% over FY11-17 which were way ahead of the industry CAGR of 12.5%. Although the bank’s deposits growth was well supported by current account and savings account (CASA) deposits (45% CAGR), however, it lagged the growth rate in term deposits (64% CAGR) over the same period. Hence, the bank’s CASA ratio continued to remain under pressure. Further, it declined to 18.6% as of FY16 from 20.4% in FY14. However, we expect SA ratio to improve meaningfully going forward as the bank continues to offer higher interest rates (5-7%) than the competition. Notably, CASA ratio touched 23% as of Q3FY17 on the back of demonetization flow. We project deposits to grow at a strong pace of ~31% over FY17-19E led by 43% CAGR in CASA deposits. Hence, we estimate the CASA ratio to improve by 80-100 bps every year over FY17-19E (23% by FY19E) driven by a higher SA ratio.

NIM to show remarkable improvement

RBL bank’s cost of deposits was relatively high due to its low CASA base and hence the bank’s net interest margin (NIM) remained lower (2.7% as of FY16) than its peers (~3.0%+). However, going forward we expect NIM to improve to 3.3% by FY19E on the back of changing loan mix toward high-yielding loans, sharp fall in the cost of bulk deposits and improvement in the CD ratio. While improvement in CASA will be an added advantage, the bank’s intention to reduce dependence on bulk deposits will also help in lowering cost of funds thereby adding to NIM.

Cost to Income (C/I) ratio to improve further

Over the last three years, RBL Bank has made significant investments in technology, processes & platforms, branches and human resources leading to higher C/I ratio. This resulted in the C/I ratio going up to 70% in FY14 from 55% in FY12 and stood at 59% in FY16. However, the bank is now positioned to avail the benefit of economies of scale post the aggressive expansion. Thus, we believe there is ample scope for improvement in the cost structure and expect C/I ratio to decline significantly from 59% in FY16 to 51% in FY19E.

Best in class asset quality

RBL bank has successfully maintained a vigorous asset quality on the back of robust risk management practices. The bank has invested in technology platforms to identify and monitor its risks. Besides, the bank is largely into working capital financing and has small exposure to stressed sectors. As a result, it has been able to maintain its asset quality amidst challenging macro environment. The bank’s Gross non-performing assets (NPAs) stood at 1.0% and 1.2% as of FY16 and FY17, respectively whereas its Net NPAs stood at 0.59% and 0.64%, respectively. Although we have factored in a slightly higher level of asset quality deterioration given the aggressive balance sheet growth, we expect the overall asset quality will continue to remain largely stable given the strong risk management practices and an improving macro environment.

The bank had total restructured assets of mere Rs92cr as of FY16, which was 0.4% (↓23 bps YoY) of the total net advances. This was further reduced to 0.3% as of FY17. Moreover, there were no additions to the restructured accounts during FY16, thus indicating reduced stress in the advances.

Net profit to grow at 37% CAGR over FY17-19E

RBL bank's net interest income (NII) and PAT has grown at a whopping CAGR of 54% and 82% over FY11-17, respectively on account of stable NIM coupled with increasing share of non-interest income. Even though the bank's profitability came under pressure in FY14 after the bank acquired Indian banking business of the RBS, the bank improved its performance remarkably post acquisition. We expect NII growth to continue to outpace the advances growth aided by margin expansion on account of increased share of the high-yielding portfolio (BBB, AB & DB&FI) despite moderation in the growth of the mid-corporate segment. Thus, we expect NII and net profit to grow at 31% and 37% CAGR over FY17-19E.

Improving operating efficiencies to drive RoE

RBL bank reported remarkable improvement in its return ratios over the last three years driven by robust business growth, improving productivity, increasing share of non-interest income and impeccable asset quality. Thus, the bank's RoE and RoA improved to 9.8% and 0.9% in FY15 from 5.1% and 0.6% in FY14, respectively. Notably, the return ratios improved further (RoE-12.2% and RoA-1.0%) in FY17. We expect the bank to continue to show an aggressive growth in the bank's balance sheet as well as earnings over FY17-19E. Further, with critical business investments largely behind, any improvement in productivity will add to the bottom-line. Thus, we expect the bank's return ratios to improve and project RoE of 16.3% and RoA of 1.2% by FY19E.

Capital infusion to improve valuation

With the bank aggressively growing its balance sheet in the past few years, the capital adequacy ratio (CAR) has come down from 17.1% in FY13 to 12.9% in FY16. However, the recent fund raising through the IPO will help the bank to maintain strong business growth momentum for the next one to two years. But, considering the present capital burn rate (11.4% Tier I capital ratio under BASEL-III as of Q3FY17), we believe the bank will require further capital infusion in early FY19. As the quantum of equity dilution is unknown, we have currently not factored the same in our model. However, any equity infusion at current levels (3.5x FY19 ABV) will be book value accretive and make valuations more reasonable and attractive for investors.

Key Risks:

- **Loan book not sufficiently seasoned:** Considering RBL Bank's elevated asset portfolio growth over the past three years, it may be too early to draw any conclusions on the bank's asset quality, given the lack of adequate seasoning.
- **Competition risk:** In the current scenario, the banking sector faces considerable competition, not just among all the banks but also from the new banks coming up post RBI's license and from NBFCs venturing into specific lending sectors. The increasing penetration of small banks and NBFCs into the Tier II, III and IV towns poses a risk to the bank's growth momentum in the future.
- **Branch concentration risk:** RBL Bank lacks a strong pan-India retail brand as its presence has historically been largely in the state of Maharashtra (48% of total branches as of FY16).

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	2,744	3,713	4,873	6,425
Interest Expense	1,925	2,492	3,274	4,330
Net Interest Income	**819**	**1,221**	**1,599**	**2,095**
Non Interest Income	491	755	950	1,285
Net Income	**1,310**	**1,977**	**2,549**	**3,380**
Operating Expenses	767	1,056	1,351	1,724
Total Income	**3,235**	**4,469**	**5,823**	**7,710**
Total Expenditure	**2,692**	**3,548**	**4,625**	**6,054**
Pre Provisioning Profit	542	920	1,198	1,656
Provisions	114	239	263	383
Profit Before Tax	**428**	**681**	**935**	**1,273**
Tax	136	235	318	433
Net Profit	**292**	**446**	**617**	**840**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Liabilities				
Capital	325	375	375	375
Reserves and Surplus	2,665	3,960	4,442	5,091
Minority Interest	-	-	-	-
Borrowings	24,349	34,588	45,345	59,462
Provisions	10,536	7,980	11,585	14,205
Other Liabilities and Provisions	1,287	1,771	1,904	2,387
Total Liabilities	**39,161**	**48,675**	**63,652**	**81,519**
Assets	2,450	4,194	4,270	5,157
Fixed Assets	2,450	4,194	4,270	5,157
Investments	14,436	13,482	17,231	21,406
Advances	21,229	29,449	38,618	50,731
Other Assets	177	259	259	259
Cash And Balances	869	1,292	3,274	3,967
Total Assets	**39,161**	**48,675**	**63,652**	**81,519**

Key Ratios (Standalone)

Y/E	FY16	FY17	FY18E	FY19E
Per share data (Rs.)				
EPS	9.6	12.6	16.5	22.4
DPS	1.5	3.8	3.0	4.3
BV	92.1	115.6	128.4	145.7
ABV	88.2	110.5	123.8	140.0
Valuation (%)				
P/E	58.4	44.5	34.1	25.0
P/BV	6.1	4.9	4.4	3.8
P/ABV	6.4	5.1	4.5	4.0
Div. Yield	0.3	0.7	0.5	0.8
Spreads (%)				
Yield on Funds	12.9	13.7	11.5	10.5
Cost of Funds	11.1	11.4	9.4	8.3
Asset (%)				
GNPA	1.0	1.2	1.3	1.3
NNPA	0.6	0.6	0.4	0.4
PCR	55.9	54.7	65.0	67.5
Management (%)				
Debt / Equity	87.2	85.1	85.2	85.3
Cost / Income	58.6	53.4	53.0	51.0
Earnings (%)	18.6	22.0	22.7	23.3
NIM	2.7	3.1	3.2	3.3
ROE	11.2	12.2	13.5	16.3
ROA	0.9	1.0	1.1	1.2

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* RBLBANK is a large-cap Bank.

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